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Holland

PROPERTY INSURANCE

BY SOLOMON S. HUEBNER, M. S.,
Ph.D.

Professor of Commerce, Univ. of Pennsylvania

THE STOCK MARKET
PROPERTY INSURANCE
LIFE INSURANCE
MARINE INSURANCE

D. APPLETON AND COMPANY
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PROPERTY INSURANCE

COMPRISING FIRE AND MARINE INSURANCE, AUTOMOBILE INSURANCE, FIDELITY AND SURETY BONDING, TITLE INSURANCE, CREDIT INSURANCE, AND MISCELLANEOUS FORMS OF PROPERTY INSURANCE.

NEW EDITION

(Completely revised and greatly enlarged)

BY

S. S. HUEBNER, Ph.D.

PROFESSOR OF INSURANCE AND COMMERCE, WHARTON SCHOOL
OF FINANCE AND COMMERCE, UNIVERSITY OF PENNSYLVANIA;
AUTHOR OF "LIFE INSURANCE," "MARINE
INSURANCE," "THE STOCK MARKET."



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*This done is damn good
with her glasses off.
- even with them on*

PREFACE

Like its predecessor, published in 1911, this volume aims to present, in a comprehensive and non-technical manner, the important economic and legal principles and the leading practices upon which the various kinds of property insurance are based. With respect to each of these kinds of insurance, special emphasis is also placed upon the nature of the coverage, types of underwriters, types of contracts and their special application, an analysis of the policy contract, special endorsements, and the factors underlying the determination of rates. The book has been prepared chiefly as a text for students of insurance in universities and colleges; who either intend to enter that vocation or who desire to understand its nature as a business and its usefulness to owners and managers of property. It is so prepared, however, as to be equally valuable to the many who are now engaged, or contemplate engaging, in the insurance business as agents, brokers, or otherwise.

The first edition of "Property Insurance" was widely adopted as a text in our higher institutions of learning and has maintained a prominent place in that respect for an entire decade. The present volume embodies in large part the author's conclusions and method of treatment in the class-room arrived at during eighteen years of teaching this subject. It represents a complete revision and a very substantial enlargement of its predecessor. The body of the text has been increased by nearly two hundred pages, and has been brought strictly to date. New chapters have been added on "Use and Occupancy, Rent and Profits

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Insurance," "The Work of Fire Underwriters' Associations," "Rate-making in Marine Insurance," "Automobile Insurance," and "Miscellaneous Forms of Property Insurance." With respect to each kind of insurance, the volume presents all essential documents and forms vital to an understanding of the contractual relation involved and the practical operation of the business. These forms are inserted throughout the text, in their proper place, for the convenience of the student, instead of being grouped in an appendix. An important feature, it is believed, is the detailed classification and arrangement, and the emphasis of subject-matter with due regard to relative importance. The volume also furnishes a classified available bibliography.

The thirty-two chapters of the text are grouped into three distinct parts, dealing respectively with "Fire Insurance," "Marine Insurance" and "Other Forms of Property Insurance." The first of these parts, relating to fire insurance, is devoted to a discussion, to the extent of a chapter in each instance, of the economic functions of insurance; the policy contract; insurable interest and assignment; the mortgagee clause; types of underwriters; agency and brokerage; description of the insured property; the risk assumed under the policy; term of the contract, renewal and cancellation; other insurance and contribution; policy provisions applying after occurrence of a loss; co-insurance; reinsurance; policy endorsements; use and occupancy, profits and rent insurance; the reserve; rates and rating methods; underwriters' associations; fire prevention; and state supervision and regulation.

Part II of the volume deals with the scientific phases of marine insurance, and the organization and practical operation of that branch of the insurance business. Where any of the principles or practices are similar to those prevailing in fire insurance, the facts are explained in Part

I under the appropriate chapters. Six chapters, however, deal with the principles and practices which pertain exclusively to marine insurance. These chapters relate respectively to "Types of Marine Insurance Policies"; "The Marine Policy Analyzed"; "Marine Perils Against Which Protection is Granted"; "Types of Marine Losses"; "Policy Endorsements in Marine Insurance"; and "Marine Insurance Rates."

Part III of the text relates to a detailed discussion of automobile insurance, fidelity and surety bonding, title insurance, credit insurance, and miscellaneous forms of property insurance. Separate chapters are devoted to each of these branches of insurance, explaining the extent of the business, its usefulness to owners and managers of property, the nature of the coverage, types of policies, analysis of the contract, special practices and endorsements, and the factors governing the determination of rates.

Special acknowledgment is due to my departmental colleague, Mr. E. L. McKenna, who gave me the benefit of his constructive criticism, especially with respect to the choice of legal citations, in the preparation of certain chapters. Many persons connected with the management of insurance companies, or otherwise identified with the business, also gave me valuable assistance throughout the preparation of the volume. To them I desire to express my appreciation for their uniform courtesy and to acknowledge my obligation for the assistance they rendered in explaining practices and in giving other information.

S. S. HUEBNER

University of Pennsylvania

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PART I
FIRE INSURANCE

PROPERTY INSURANCE

CHAPTER I

THE FUNCTIONS OF FIRE AND MARINE INSURANCE¹

Definition of Insurance.—Fire insurance has been defined as “that social device for making accumulations to meet uncertain losses of capital through fire, which is carried out through the transfer of the risks of many individuals to one person or a group of persons.”² The same definition is also applicable to marine insurance, except that the perils against which protection is granted comprise not only fire, but in addition, the perils of the sea, enemies, thieves, jettison, barratry, and other hazards of a like nature.

All industry involving the ownership of property is more or less subject to risk of loss through fire and the elements, and in all business enterprises it is the desire of the capitalist to eliminate this risk as far as possible. Three methods of elimination may be used: either the

¹The best treatment of this subject is found in Allan H. Willett's “The Economic Theory of Risk and Insurance.” Excellent brief discussions are also found in F. C. Moore's introductory chapter to his work on “Fire Insurance and How to Build,” and in Richard M. Bissel's lecture on the “Place of Fire Insurance in the Financial World.” These sources, especially the first two, have been drawn on to a considerable extent in this chapter.

²Allan H. Willett, “The Economic Theory of Risk and Insurance,” Macmillan Co., New York, 1901, p. 106.

2 PROPERTY INSURANCE

capitalist may adopt measures for preventing the origin and spread of fire; or he may decide to carry the risk himself, and as a consequence pay a higher rate of interest on the capital he borrows and puts into the business; or he may buy insurance, and for a definite sum, called the premium, transfer the risk to some other person, or group of persons, called the insurer.

All three of these methods are used by the capitalist of to-day, and the cost of each enters into the cost of production. The extent to which each is used will depend chiefly upon its relative cost. Statistics, however, show that during each succeeding decade a larger proportion of the country's wealth, subject to the uncertainty of loss through fire or marine perils, has been protected by insurance placed with corporations.

Extent of Fire and Marine Insurance Business.—The fire and marine insurance business of the country, and for that matter insurance along all important lines, has had a most remarkable development during the last twenty-five years. Less and less of the total risk is borne by the capital in the industry, and more and more reliance is placed upon insurance and fire prevention. Competent estimates³ place the value of property in the United States protected by fire insurance in excess of \$100,000,000,000. About ninety per cent of the insurance written in the United States, it is estimated, is reported to the Insurance Department of the State of New York, and at the close of 1918 this business was distributed approximately as follows: American stock companies, \$58,000,000,000, foreign stock companies, \$21,000,000,000, and mutual companies (all classes) \$6,000,000,000. It is also estimated that at the close of 1918 the

³ Report of Special Committee on Fire Waste and Insurance to the Chamber of Commerce of the United States, 1918.

factory mutuals of the country carried risks aggregating approximately \$5,000,000,000, and farmers' mutuals about \$6,000,000,000. A special Committee on Fire Waste and Insurance recently reported to the Chamber of Commerce of the United States that "the total cost of the fire hazard in the United States cannot be far from \$750,000,000 a year." Of this total the value of property burned per year averages approximately \$300,000,000, whereas in years of catastrophe the total rises to \$500,000,000. But to this actual loss there must be added another quarter of a billion dollars to cover the expense of operating the insurance business in all its forms. There must also be added the heavy costs involved in the equipment and maintenance of fire departments and other similar agencies. To quote the Committee's report: "In 1918 one hundred forty-six of the two hundred twenty-seven cities of the United States exceeding thirty thousand in population spent \$52,000,000 for operation of fire departments alone, or more than one-fourth of the sum they spent for schools. Sixty-nine of these cities had, in addition to \$115,000,000 invested in buildings and equipment for fire departments, \$1,200,000,000 invested in water-supply systems, a portion of which (perhaps one-fourth) should be chargeable to fire fighting."

Marine risks written and renewed during 1918 by all companies, domestic and foreign admitted, operating within the United States, exceeded \$66,000,000,000. Of this total, branch offices of admitted foreign companies wrote or renewed 58.4 per cent, American companies controlled abroad through stock ownership, 5 per cent, and American companies, 36.6 per cent. These figures, however, do not reflect the total marine insurance originating in the United States. Competent underwriters estimate that at least 20 per cent of all marine insurance originating in this country is exported directly abroad by brokers

and others to be placed with non-admitted underwriters or with the home offices of admitted foreign companies.⁴

Benefits Derived from Fire and Marine Insurance.—*“Substitution of certain for uncertain loss.”*—Viewed from the standpoint of society in general, as contrasted with the individual property owner, the economic value of fire and marine insurance is indirect rather than direct in character. It is apparent that the insurance of property does not in the least reduce the amount of fire waste. During the last fifteen years, 1906 to 1920 inclusive, over \$3,680,000,000 worth of property, representing an average annual loss of \$245,000,000, was destroyed by fire in the United States. This enormous amount of property, wasted annually by fire, is gone forever. It is not replaced by insurance, since the insurance company has merely collected premiums from the many whose property is not destroyed, in order to indemnify the unfortunate owners whose property is lost.

If insurance, therefore, does not prevent the destruction of property, and does not directly increase the wealth of the community, to what shall we attribute its principal value? The answer is that the real gain derived from insurance is due to the combination of a large number of separate risks into a group, thus making possible the “substitution of certain for uncertain loss.” The larger the number of separate risks combined in a group, the less uncertainty will there be as to the amount of loss, since the law of average will apply with greater precision; and the less uncertainty of loss, the smaller is the accumulation of money necessary from the many to meet the losses of the few. In fact, if the aggregate of risks combined in a group were so large as to make the application of the

⁴For a detailed discussion of the volume of marine insurance written see S. S. Huebner: “Report on Status of Marine Insurance in the United States,” Washington, 1920.

law of average perfect, and thus remove all uncertainty as to the amount of loss that will be experienced during a given period of time, the accumulation of money through premiums from property owners (leaving out of account the expenses and reasonable profits of the insurer) would be limited to the exact amount of the expected loss.

It is in the application of this principle that the nature of the gain to society from the institution of insurance becomes apparent. Thus, let us assume that there are five thousand owners, owning five thousand houses, valued at \$10,000 each, and alike in all respects. Let us also assume that the average annual loss, as shown over a considerable number of years, amounts to $\frac{1}{2}$ of 1 per cent of the value, although for individual years the loss varies from a minimum of $\frac{1}{4}$ of 1 per cent to a maximum of 1 per cent. Now, were there no system of insurance, it is apparent that these five thousand owners, if they wish to eliminate the element of gamble, would have to make a liberal addition to the rental in order to cover the uncertainty of loss by fire, to which each is exposed. How much each would add, is a matter of conjecture, but it is conservative to assume that each would demand at least an extra 5 per cent on his investment, or \$500 per year, or \$2,500,000 for the entire group, because of the risk assumed. But even at this extra rate of 5 per cent, these house owners would be making a gamble at odds of 1 to 20.

But let us now assume that these five thousand owners combine their risks into one group. It must be clear that by doing this they have substituted for the great uncertainty of loss which confronted them as individuals, a certain and definitely known loss, amounting on the average to $\frac{1}{2}$ of 1 per cent, or \$50 per house, and only \$250,000 for the group. Without the aid of insurance all these owners would be obliged to increase their rentals by at least ten times the amount needed to cover their losses,

and at the end of the year the great majority of them, since they had suffered no losses, would have the entire sum as a net gain, while the unfortunate few would be losers to many times the extra sum charged. In each case the charge for the risk was shifted to the tenant, and he had to pay considerably more each year than he would have been called upon to pay if the uncertainty of loss had been removed by a system of insurance. "The risk that an insurance company carries is far less than the sum of the risks of the insured, and as the size of the company increases the disproportion becomes greater."⁵

Just as the rent payer is benefited, so it can be shown that insurance benefits all consumers, since it reduces the cost of practically all commodities by diminishing that part of the cost of production which the manufacturer must necessarily set aside as a fund for protection against risk. Were there no system of insurance, it is apparent that the owner of a vessel, if obliged to carry the risk himself, would naturally want as a precautionary measure to increase his freight charges by at least 10 or 20 per cent. And even then he would be gambling at heavy odds since an early loss, before his self insurance fund had reached an appreciable amount, would largely wipe out his equity. Under marine insurance, however, this vessel owner can substitute for the great uncertainty, confronting him as an individual, a certain and definite loss (the premium) probably amounting on the average to not more than one-tenth of the allowance considered necessary under a non-insurance system. The burden of the consumer is limited to this smaller premium whereas in the absence of insurance it would be increased substantially. By thus eliminating uncertainty, marine insurance greatly reduces the margin of profit wanted in commercial transactions.

⁵ Allan H. Willett, "The Economic Theory of Risk and Insurance," New York, 1901, p. 108.

Merchants are enabled to handle goods on a much narrower margin of return, since they are assured of their expected trade profit. Vessel owners are no longer compelled to accumulate a substantial fund to meet uncertain hazards; while creditors assured of the greater financial stability of borrowers will feel freer to enlarge their loans and to reduce their rates of interest.

Correct inspection and rating of risks.—Reduction of the element of uncertainty, resulting from a combination of risks, is by no means the only benefit of insurance to the business community. It is very important that insured risks in different localities and in various classes of property should be inspected and rated correctly, and that justice should be done between different property owners. The ability of men to judge such risks varies greatly, and the problems connected with the fixing of rates are difficult and intricate, since the number of elements which make up the hazard to which insured property is subject is almost infinite. Any one will recognize the difference between a manufacturing plant and a dwelling from the standpoint of fire hazard, and such distinctions exist between hundreds of different types of property. Again, hardly two buildings within a given class of risks can be considered as identical, since they differ in their construction, their environment, and their equipment of devices for preventing and extinguishing fires. Almost every substance and process of manufacture will, under certain circumstances, be the cause of fire. According to a leading schedule there are more than a hundred features of construction in a single building which should enter into the determination of its rate. There are nearly forty features of the city or environment which are important, and nearly forty more of fire appliances. Lastly, there must be considered the hundreds of possible uses to which a building may be put. Similarly, with respect to marine insurance, it is

important that types of vessels and cargoes and the numerous circumstances connected therewith in different voyages and seasons, or under different methods of loading and handling, should be estimated and rated correctly.

Naturally the task of estimating risks, when surrounded by so many features, all of which must be taken into consideration, should be undertaken only by those who make this a regular business, i.e., by those who engage in the fire and marine insurance business. To judge between safe and unsafe risks, and charge rates which are just and adequate, requires that the underwriter should have a knowledge of every business which he agrees to insure. As Mr. F. C. Moore states,⁶ "There is probably no calling requiring so intimate a knowledge of every other as this. He who assumes the risk of a flour mill, for example, should know more of its dangers than the miller himself. . . . Drawing a greater number of contracts in a year than do many lawyers in a lifetime, and standing often face to face with the most perplexing questions of jurisprudence, it may be questioned if he should know less than does the attorney who has made it his profession. Seriously affected by every discovery of the chemist, and liable, at any moment, to have his chances of loss on whole classes of risks alarmingly increased by new chemical combinations which follow each other as rapidly as the changes of a kaleidoscope, he should know not less of them all than does the chemist himself. In short, there is scarcely a science, art, or manufacture with which he should not be more or less familiar, and if the successful conduct of any one business or calling requires a lifetime of study and application, how much more should the business of insurance—which demands a knowledge more or less intimate of every other—require lifelong study and the closest

⁶ F. C. Moore, "Fire Insurance and How to Build," pp. 22 and 23.

and most constant observation." Facts like these serve to show the importance of having a specialized business for the assumption of the risks of the many producers who are ignorant of the relative fire hazard connected with different types of property. Moreover, the natural ability of the insurers will constantly be developed through the experience and training which their work gives.

Increasing efficiency by eliminating worry.—Insurance also serves a very useful purpose in increasing the efficiency of men by enabling them to venture more willingly. As early as 1601 the British Parliament (43 Elizabeth, C. 12) gave expression to this advantage of insurance by describing marine insurance as a means "whereby it cometh to pass that upon the loss or perishing of any ship there followeth not the undoing of any one, but the loss lighteth rather easily upon many than heavily upon few, and rather upon them that adventure not, than upon those who do adventure; whereby all merchants, especially those of the younger sort, are allowed to venture more willingly and freely." During the recent international war, marine insurance proved so essential to the free movement of commerce, the very life blood of nations, that at least half a dozen of the allied Governments, including the United States and Great Britain, saw fit to enter the insurance business at rates thought to be lower than cost.

There are many who, while capable of engaging in comparatively safe industries, would have their efficiency in business seriously curtailed, if compelled to gamble with the chance of loss through the elements. By being able to transfer these risks of loss to insurance companies for a definitely stipulated premium they are relieved from the paralyzing anxiety which results from uncertainty, and are free to direct their energies along other lines. The value of insurance to the individual property owner, who does not wish to gamble with chance, consists in the dif-

fusion of one individual's loss over a large group of individuals. Insurance takes a loss, sufficiently heavy to ruin one property owner, and by distributing it over thousands of others, who pay premiums to the same company, makes the loss but lightly felt. The losses resulting from the Chicago, Boston, Baltimore, and San Francisco conflagrations would have had a paralyzing effect upon those communities for years if there had been no certain method of indemnifying the losers. But the property owners of these cities carried insurance in scores of companies, situated in nearly every leading country, and representing millions of policyholders in all parts of the world, whose contributions in the form of premiums at once became available for the rebuilding of these cities. Fire insurance "is closely and inseparably interwoven with every scheme of profit and trade, a strong, continuous warp-thread which lends security to the fabric, and without which it is doubtful if the temerity of the capitalists would meet the necessities of the poorer population for employment."'

Basis of our credit system.—But fire insurance plays another very important rôle, besides those already enumerated. It is the support of commerce and industry in so far that it is the basis of our whole credit system. The importance of insurance in this respect becomes apparent when we reflect that only about 5 per cent of the world's business is conducted on a cash basis, and that 95 per cent is based on credit.

A thousand illustrations can be cited to show the far-reaching influence of fire and marine insurance upon our credit system. A cargo of grain is shipped from the United States to Europe, and is paid for through the shipment of a cargo of manufactures from Europe to America. Here we have a transaction based on credit and consum-

'F. C. Moore, "Fire Insurance and How to Build," p. 21.

mated without the use of cash. Commodities are used to pay for commodities, and, owing to the costliness of settling international debts by the actual transfer of gold from one country to another, this practice is almost invariably adopted. The whole transaction is based on credit, and the important thing to remember is that the foreign exchange banker, who undertakes the financial settlement of these two shipments, knows that this credit is guaranteed by a fire and marine insurance policy. The insurance of these cargoes in reliable companies makes the transaction as certain as though all payments were made in cash. If the property involved in any of these shipments had been destroyed by fire or by the perils of the sea, the creditors would nevertheless be protected, since the loss would be made good by the insurance companies.

Without fire insurance as collateral security the wholesale merchant could not extend credit to the retailer. But with the goods insured in a reliable company against loss by fire, the wholesale merchant can grant an able and honest retailer credit to the extent of five times his capital, and at the same price he would demand if paid cash. Because of the protection promised by an insurance company the wholesaler advances the goods to the retailer. He knows the retailer to be honest and able, and that when the goods are sold he will receive his payment out of the proceeds of the sale. The only risk is the danger of destruction of the goods before the retailer has sold them, thus probably making their payment impossible. Through insurance this risk is eliminated, and the retailer becomes a cash trader, as far as the securing of favorable terms from the wholesaler is concerned.

In the same way, the wholesaler, if he is operating on borrowed money, can secure the most favorable rate from the lender of credit, if he protects his banker or the manufacturer of the goods with an insurance policy. In buying

the goods the wholesaler may pay only 10 per cent of the purchase price in cash, the remaining 90 per cent being advanced as a loan by the banker or manufacturer, the security for the loan being the goods themselves, but only when insured against loss by fire. Of course, the wholesaler or retailer, as the case may be, must pay for the insurance, but the reduced price at which he gets the goods, or the favorable rate of interest at which he secures the credit, pays for this insurance over and over again. As an insurance policy may be made to cover all stock that goes into a store from time to time during the term of the policy, \$10,000 of insurance may, in the course of a year, have under its protection from \$50,000 to \$75,000 worth of merchandise, thus distributing the cost of the insurance over large property values.

It may be shown in another way that fire insurance enables a man with limited capital to transact a business much larger than he otherwise could do. Assume a grain dealer to be the possessor of \$40,000 capital. With this capital he purchases wheat in the West at \$1 a bushel, with a view to selling it in the East or storing it in a warehouse for a more favorable market. If this grain dealer's transactions were limited to cash purchases of wheat, he would probably be obliged to wait several weeks before he could sell his grain and liberate his capital for a new purchase, and his profit would be exceedingly small, since modern competition in that business enables him to realize a profit of only one to two cents per bushel. Grain dealers cannot afford to transact business on this basis, and all are obliged to resort to the use of credit. Instead of limiting his purchases to 40,000 bushels, our dealer will at once have this wheat inspected, graded, and represented by warehouse receipts. He will also have it insured against loss by fire in a reliable company. Then he will take the warehouse receipts, representing the wheat, and the in-

insurance policy to his banker as collateral security for a loan, and the banker will lend him money, probably, to the extent of 90 per cent of the value of the wheat, or to \$36,000. Assuming wheat to remain at \$1 a bushel, the dealer can at once purchase 36,000 bushels more with the proceeds of this loan. This new purchase of wheat will again be represented by new warehouse receipts, and will again be protected by fire insurance. The warehouse receipts and the policy covering the 36,000 bushels can again be offered to the banker as collateral security for a new loan of 90 per cent of the value, or say \$32,400. With this new loan the dealer can at once purchase more wheat, can insure it, and with the new warehouse receipts and the fire insurance policy as collateral obtain another loan, and with this loan buy more wheat. By repeating the operation until his original capital has been absorbed in margins, it becomes clear that this grain dealer, though he started with only \$40,000 capital, is nevertheless enabled, through the use of fire insurance, to do a \$300,000 business, and accordingly makes seven or eight times the profit he could realize if his business had been restricted to cash transactions. The banker is willing to extend the credit, partly because he knows that wheat always has a ready market on our big produce exchanges, thus, in case of a decline in price, giving him a chance to sell the same before the margin of ten per cent on the loan is exhausted, and partly because the fire insurance policy protects him against the loss by fire of the security back of his loans. Likewise the exporter of a cargo of cotton may insure it under a marine policy, and with the policy and bill-of-lading as collateral may at once command money, at the usual rate of interest, with which to buy another cargo and repeat the operation.

Insurance also helps to build homes, since the owner of ground who wants to build a home can borrow a larger

sum of money on the building, if insured, and at a more favorable rate, than he could if there were no insurance. Mortgagees, as we shall see in another chapter, invariably have their interest in the mortgagor's property protected by an insurance policy. In a hundred ways it can be shown that fire and marine insurance have become absolute necessities of trade, without the assuring protection of which the large undertakings of to-day would be a gigantic gamble, and would never be attempted if liable to miscarry through a single fire or marine disaster. As it is, enormous sums are borrowed on stocks and bonds and warehouse receipts; merchants sell their wares on credit; investors furnish millions for the upbuilding of vast industries supporting whole towns; capitalists make loans on buildings worth many times the value of the ground on which they are built—all being willing to do this because they know that the insurance policy stands as collateral between them and loss.

Marine Insurance a national commercial weapon.—Thus far attention has been directed solely to the services of fire and marine insurance as fundamental instruments of business and commerce. But our list of functions of insurance would not be complete if reference were not made to the vital importance of marine insurance under American auspices as a strategic agency—a commercial weapon—in the maintenance of an American merchant marine and the development of our foreign commerce. Foreign trade is always a subject of keen rivalry between nations, and emphasis should, therefore, be given to the necessity of the possession of a strong national marine insurance institution as a powerful weapon for acquiring and controlling important channels of foreign commerce.

The cost of hull and cargo insurance constitutes an important element in the operation of vessels and the sale of goods. Under modern competitive conditions, a

slight difference in insurance rates often represents the difference between operation at a profit and operation at a loss. Again, our leading competitors have for years used this type of insurance as a means—as a national commercial weapon—of controlling leading lines of trade for their own merchants, their own steamship lines, and their own banks. Nations adequately equipped with marine insurance facilities may deny the service altogether at strategic times, or give it only under unfavorable conditions, to the citizens of countries that do not possess adequate facilities of their own. Marine underwriters also necessarily become acquainted with the leading facts surrounding consignors, consignees, carriers, costs of production, methods of packing, handling and doing business, financial affiliations, and the conditions and price of sales, and for this reason adequate underwriting capacity, free from foreign control, is essential to the proper protection of our trade secrets.

CHAPTER II

THE POLICY CONTRACT IN FIRE INSURANCE

Fire Insurance Policy a Personal Contract.—A fire insurance policy is a personal contract which promises, in accordance with the restrictions expressed in the contract, to indemnify those who have an insurable interest against all actual direct loss or damage by fire to property as described in the policy. According to the above definition a fire insurance policy should be viewed as a contract, which, strictly speaking, does not insure the property but the persons who own the property or have an insurable interest therein. The importance of the personal factor in fire insurance cannot be over-emphasized. If, for example, we assume two buildings to be alike in all respects except ownership, the insurance company will have to regard these two risks as different as day is from night, if the one is owned by an honest man, and the other by a person who will not hesitate to realize from a dishonest fire. Dishonest carelessness and actual incendiarism are playing a large share in the enormous annual fire waste of the country, and there is scarcely a business which offers such temptation for gain through criminal procedure as does fire insurance. In fact, there is probably no type of contract in which one party (the insurer) is so absolutely at the mercy of the other (the insured). Overinsurance must by all means be guarded against, and yet for the benefit of the general public the company cannot obtain an accurate valuation of the property at the time of insurance. Only an approximate

estimate can be made at best, for to do otherwise in the case of all properties insured would involve a very considerable expense and an unnecessary increase in the rate of premium.

Since the fire insurance policy must of necessity be regarded as a personal contract, it is clear that the policy does not follow the property unless the company gives its consent. Any other rule would mean that a given property would remain insured even though it passed from an honest and careful owner to a dishonest or careless one, and was thus changed from a good to a bad risk. It is only fair to the company and the public that when a policy is assigned to another person, the company should have an opportunity to know the insurable interest back of the assignment, and to give its consent. Likewise it is only fair that the policy should become null and void if any change takes place in the interest, title, or possession of the subject of the insurance, unless the company has been made acquainted with the fact, and has given its consent to the change.

The Fire Insurance Policy a Contract for Indemnity.—

It is a fundamental principle of fire insurance, often lost sight of by our law-making bodies, that the contract is one of indemnity for actual loss. This means that no matter what the stated value of the property may be in the policy, the insurance company is not liable, unless the policy expressly provides to the contrary, for more than the actual value of the property at the time of the fire. Observation will show that any other rule might work the greatest injustice and make possible wholesale fraud. Values of real estate, and especially of personal property, are constantly changing, and frequently great depreciation in value occurs between the issuance of the policy and the time of loss. Stocks of goods may go down in value because out of season or because of a

change in style. Machinery may depreciate through wear and tear, and buildings may be worth less when destroyed because of cheaper labor and building materials, or because they cannot command the same rental as formerly. Now if an insurance company were obliged, in case of a total loss, to pay the full value stipulated in the policy, irrespective of the true lower value, the policyholder would actually be in a position to benefit from a fire. This is contrary to the very idea of "indemnity," because that term implies that the insured should be compensated for loss actually incurred, but should never find the insurance contract a source of profit.¹

Nature of the Indemnity Promised.—The fire insurance contract indemnifies only for actual destruction of *material* values, i.e., for the *fair cash market value* of the property at the time of the loss. In other words, the company is not liable for sentimental values, such as are frequently associated with gifts, portraits, objects of art, documents, heirlooms, etc.

Furthermore, liability under the fire insurance policy is limited to loss or damage which is traceable directly to fire, i.e., where "the damage accrues directly from fire as a destroying agency in contrast to the remoteness of fire as such an agency." There are many instances, for example, where fires of very small size cause enormous loss because of a peculiar chain of circumstances, such as a small fire reaching charged wires, or a spark coming in contact with explosives. The interesting question arises as to the extent of the insurer's liability for such losses. This can only be answered by determining whether or not the loss is directly traceable to fire. Is fire the real cause, and if so, is the sequence of events between the origin of

¹ Will be discussed at greater length in the Chapter on "The Risk Assumed."

the fire and the destruction of the property (the two may involve locations distantly separated from each other) an unbroken one, or has some outside force, such as an act of God, intervened to bring about or increase the loss? This question is of the greatest importance to both parties in innumerable cases, and will be discussed in greater detail in another chapter.²

Rules Underlying the Interpretation of the Contract.

—Referring to our definition of a fire insurance contract, we find that “indemnity” as outlined above is promised only “in accordance with the restrictions expressed in the policy.” The larger part of the insurance contract consists of numerous promissory and restrictive provisions which aim to govern the conduct of the insured in the safeguarding of the property, or to protect the company against the payment of unnecessary or dishonest losses. In considering these provisions, it should be borne in mind that the fire insurance contract is general in its nature, and was drawn to meet a general situation, and not with reference to a particular case. And yet there are scarcely two fires in which the circumstances are exactly alike. Innumerable cases arise which require a special application of the general terms of the contract in order to realize the purpose for which the contract was written, viz., to protect against loss.

There is scarcely a provision in the policy to-day which at some time or another has not been the subject of interpretation by the courts, and there are many provisions concerning which, chiefly because of ambiguity in the wording, varying circumstances surrounding the loss, or statutory requirements, there are conflicting opinions. The principles of fire insurance are but little understood by the general public. The interests of the insured often

² See that part of the Chapter on “The Risk Assumed” which deals with “The Doctrine of Proximate Cause.”

seem at variance with the interests of the insurer, and the attitude of state legislatures has often been one of hostility to the latter. Nothing seems fairer, for example, than that the company should not pay more than the actual value of the property at the time of the fire. Yet this basic rule, which underlies the very idea of indemnity, is not appreciated or understood in many sections of the country. Its application has actually been prohibited by the legislatures in a large number of the states, in the case of a total loss of buildings, and the courts have seen fit to uphold the law. Under these conditions, it is not astonishing to find that disputes should frequently occur as to the interpretation which should be given to the general provisions of the policy when unexpected circumstances surround the particular loss. Forfeitures are viewed with disfavor by the courts, because the sums involved are usually large. Wherever possible, it is the desire of the court to consider the policy in the light of existing circumstances, and to enforce it for the benefit of the insured, unless, of course, such action would be contrary to the definitely expressed terms of the contract. "In their interpretation," according to Ostrander, "the courts are without any infallible rule to guide them, and necessarily often differ in their judgment of the law, and thus there has come to exist a good deal of conflict among authorities." But, however great this conflict of authority has become, there are certain legal principles which underlie the application and interpretation of fire insurance contracts, and which are constantly kept in mind by the courts to assist them in their efforts to enforce the contract. Briefly summarized, these principles are the following:

Benefit of doubt to insured in case of ambiguity.—When the wording of any provision in the policy lends itself to more than one construction, the courts will give the benefit

of the doubt to the insured, and will reject that construction which limits the liability of the company. In *Liverpool Insurance Company vs. Kearney*, 180 U. S., 132, the court explained this rule in the following words: "To the general rule there is an apparent exception in the case of contracts of insurance, namely, that where a policy of insurance is so framed as to leave room for two constructions, the words used should be interpreted most strongly against the insurer. This exception rests upon the ground that the company's attorneys, officers, or agents prepared the policy, and it is its language that must be interpreted."

Conceding that this should be the general rule in all cases where the company is free to adopt the policy form, what shall be said of the application of this rule where the policy form is prescribed by statute law and made compulsory for all companies writing insurance in the state? If the policy is a statute, should its terms not be binding equally upon both parties, or shall the insured still receive the benefit of the doubt? The question was decided favorably to the insured in the case of *Matthews vs. American Central Ins. Co.*, 154 N. Y., 449. "The policy," the court declared, "although of the standard form, was prepared by the insurers, who are presumed to have had their own interests primarily in view, and hence, when the meaning is doubtful, it should be construed most favorably to the insured, who had nothing to do with the preparation thereof. Moreover, when a literal construction would lead to manifest injustice to the insured and a liberal but still reasonable construction would prevent injustice by not requiring an impossibility, the latter should be adopted because the parties are presumed, when the language used by them permits, to have intended a reasonable and not an unreasonable result."

Endorsements control the regular provisions of the policy.—Since insurance policies are general in character

and not prepared for particular cases, it follows that special agreements must frequently be endorsed on the policy with a view to modifying the original terms of the policy form. Whenever there is a difference in meaning between such endorsements and the policy form itself, it is a generally recognized principle that the superimposed parts of the contract, whether written or stamped or printed, control the regular provisions of the policy. This principle is based on the theory that anything endorsed on the policy must be later in date than the policy itself, and is thus presumed to represent the latest agreement between the parties. If any ambiguity exists in the wording of any such endorsement, the insured must again be given the benefit of the doubt. ✓

Each policy is an independent contract.—Every insurance policy must be regarded as an independent contract, the interpretation of which depends upon its own terms and is not affected by the terms of any policy which preceded it, unless the insured and insurer have expressly agreed that the contrary shall be the case. This is an important principle in its application to the renewal of policies, and will be discussed at greater length under that subject.

Forfeiture generally limited to the continuance of policy violation.—By the weight of authority, a violation of the conditions of the policy will cause a forfeiture only during the time that the violation continues. If, after a violation, the conditions of the policy are again complied with, the policy revives, even though the company never consented to the violation. Unfortunately the courts of the various states have rendered conflicting opinions on the important question of the effect which a violation of its terms has upon the life of a policy. Thus in New York and Pennsylvania, if a policyholder vacates his building contrary to the policy and without the consent of the com-

pany, the act works a forfeiture during the period of vacancy, but if afterwards the building is again occupied and a loss occurs the company will be held liable, because the policy is considered to be revived when the violation is discontinued. In other states, however, such a violation nullifies the policy, and the policy once void will remain so, unless the insurer consents to its restoration.

Development of the Standard Policy.—Having stated the general principles which govern the interpretation of fire insurance contracts, let us now trace the evolution of the so-called standard policy. At first fire insurance was written almost entirely by individual underwriters whose operations were few in number, and generally confined to risks with which they were personally acquainted. The policy was brief in its terms, and included merely the description of the property, the amount of insurance, the term, and the premium. Soon, however, individual underwriting proved inadequate for the needs of the business community. A prime requisite in insurance is the financial strength of the insurer; and, as business developed in size, larger and larger sums of capital were necessary to furnish proper security to the public. Hence it came about that corporations everywhere began to supplant individuals as underwriters.

At first these corporations solicited insurance directly from their home offices. But with the growth of competition between the many companies that were springing up in all the leading Eastern cities, greater and greater reliance had to be placed upon the agency system. Representatives of the companies had to be stationed in the various towns so as to be easily and promptly accessible to property owners. The result was that with the spread of its underwriting activities over a larger area, the company was exposed on the one hand to possible dishonesty or incompetency on the part of the local agent, and, on

the other, to an increased moral hazard on the part of the insured. With the creation of agencies in all business communities it was only natural that the company should seek to protect itself and the public against the willful destruction of property by those who could not now be watched carefully. Many promissory and restrictive provisions had to be incorporated in the policy which would tend to protect the insurer against unnecessary risk and the payment of unjust claims. It was essential that the policy should now contain a full description of the property, and, on penalty of forfeiture, prevent concealment of facts prior to the issuance of the policy, and wrongful conduct in the maintenance and care of the property after the owner had secured the policy.

The incorporation of such restrictive provisions tended at this time not only to make the fire insurance policy a very voluminous contract, but all semblance of uniformity in the wording of different policies seemed to disappear. Each company had a policy of its own. In fact, the policy was local in character, one form prevailing in Boston, another in Philadelphia, and still another in New York. No coöperation of importance existed between the several companies, and the problem was made worse on the one hand, by the desire of some companies to enhance their business by the issuance of attractive special policies, and on the other, by the desire of a certain number of companies to defraud the insured of his rightful claim by the strict application of a skillfully drawn contract. The multifarious character of policy forms at this time is well described in a court decision in the following words:³

³Delancy vs. Rockingham Farmers Mutual Fire Insurance Co., 52 N. H., 581. This decision is also very extensively quoted on pages 182-83 of the "Annals of the American Academy," September, 1905.

“Forms of applications and policies (like those used in this case), of a most complicated and elaborate structure, were prepared and filled with covenants, exceptions, stipulations, provisos, rules, regulations, and conditions, rendering the policy void in a great number of contingencies. These provisions were of such bulk and character that they would not be understood by men in general, even if subjected to a careful and laborious study; by men in general they were sure not to be studied at all. The study of them was rendered particularly unattractive by a profuse intermixture of discourses on subjects in which a premium payer would have no interest. The compound, if read by him, would, unless he were an extraordinary man, be an inexplicable riddle, a mere flood of darkness and confusion. Some of the most material stipulations were concealed in a mass of rubbish on the back side of the policy and the following page, where few would expect to find anything more than a dull appendix and where scarcely anyone would think of looking for information so important as that the company claimed a special exemption from the operation of the general law of the land relating to the only business in which the company professed to be engaged. As if it were feared that notwithstanding these discouraging circumstances, some extremely eccentric person might attempt to examine and understand the meaning of the involved and intricate net in which he was to be entangled, it was printed in such small type and in lines so long and so crowded, that the perusal of it was made physically difficult, painful, and injurious.”

This utter lack of uniformity in fire policies proved to be exceedingly unfortunate for both insured and insurer. The policyholder, scarcely once in a hundred times, carefully studies the policy he procures. When every company issued its own special policy, many of them models of ambiguity, it frequently happened that the insured, when a loss occurred, found himself deprived of the indemnity on which he had confidently relied. The companies, on the

other hand, had to contend with a multiplicity of court decisions in the various states, many of which were in direct opposition to others, although dealing with the same subject. Everywhere the courts were called upon to pass on the interpretation of loosely drawn policies, and in their efforts to give the benefit of the doubt to the insured, and prevent a forfeiture on a poorly or skillfully drawn contract, as the case might be, they helped to develop a system of court law in insurance, which for its conflicting opinions has probably no parallel in any other line of business. The effect of these decisions is marked even at the present day, although nearly everywhere approximately the same policy is in use. "It would be well," writes Mr. F. C. Moore, "in all cases of lawsuits to bear in mind that when decisions are glibly quoted to sustain interpretations of particular phrases, that the policy in question before the court may have been very differently worded from the standard form now in use."⁴ Again, when large fires occurred, and several policies had been written on the property, it was common to find that they were unlike in their terms and application, thus making a settlement of the loss among the several companies impossible, except by an unsatisfactory compromise.

With such inconveniences resulting from a lack of uniformity in the terms, it was only natural that a sentiment should develop for the establishment of a "standard" policy, which when universally used by all companies would in the course of time be interpreted definitely by the courts, thus enabling the policyholder to be sure of its meaning. The first important attempt to adopt such a standard policy was undertaken by the National Board of Underwriters in 1867 and 1868. Then followed the law of 1873 in the State of Massachusetts, providing for a standard form of policy, which in 1880 was made

⁴"Fire Insurance and How to Build," p. 556.

obligatory for all companies writing business in the state. Six years later a standard form was adopted by the legislature of New York, and made obligatory in the following year, 1887. This policy, going under the name of the "New York Standard Fire Policy," was later adopted as a statute in a considerable number of other states, and was also used wherever permitted by most of the largest companies. From time to time this policy has been improved. (For present New York Standard Policy, see copy attached to this Chapter). Quite a number of states have adopted special forms of standard policies, differing somewhat but not radically from the New York form. In other states, although not made mandatory by law, the New York form is generally used by nearly all the companies.

Grouping of Policy Provisions.—For purposes of discussion the main provisions of the standard fire policy may conveniently be classified under the following heads:

1. The parties to the contract, including insurable interest and agency.
2. Description of the property.
3. The risk assumed.
4. The term of the contract, involving renewal and cancellation.
5. Other insurance on the same property, involving contribution.
6. Endorsements granting special privileges or imposing restrictions.
7. Provisions applying after a loss has occurred.

As regards each of these groups the provisions of the policy will be discussed in the following chapters with reference to their purpose and meaning, and the most important interpretations that have been placed upon them by the courts.

COPY OF NEW YORK STANDARD FIRE POLICY

No.

INSURANCE

COMPANY

Of

_____, New York

Amount \$ Rate Premium \$

In Consideration of the Stipulations herein named

and of Dollars Premium
does insure

and legal representatives, to the extent of the actual cash value (ascertained with proper deductions for depreciation) of the property at the time of loss or damage, but not exceeding the amount which it would cost to repair or replace the same with material of like kind and quality within a reasonable time after such loss or damage, without allowance for any increased cost of repair or reconstruction by reason of any ordinance or law regulating construction or repair and without compensation for loss resulting from interruption of business or manufacture, for the term of

from the day of 192 .., at noon,

to the day of 192 .., at noon,

against all DIRECT LOSS AND DAMAGE BY FIRE and by removal from premises endangered by fire, except as herein provided, to an amount not exceeding

Dollars, to the following described property while located and contained as described herein, or pro rata for five days at each proper place to which any of the property shall necessarily be removed for preservation from fire, but not elsewhere, to wit:

This policy is made and accepted subject to the foregoing stipulations and conditions, and to the stipulations and conditions printed on the back hereof, which are hereby made a part of this policy, together with such other provisions, stipulations and conditions as may be endorsed hereon or added hereto as herein provided.

PROVISIONS REQUIRED BY LAW TO BE STATED IN THIS POLICY:—This Policy is in a stock corporation, and is issued under and in pursuance of Sections 130, 131 and 132 of the Insurance Law of the State of New York.

In Witness Whereof, this Company has executed and attested these presents; but this policy shall not be valid unless countersigned by the duly authorized Agent of the Company at

Countersigned at President.

this day of 192

..... Agent.

..... Secretary.

- 1 **Fraud, misrepresentation, etc.** This entire policy shall be void if the insured
2 has concealed or misrepresented any ma-
3 terial fact or circumstance concerning this
4 insurance or the subject thereof; or in case of any fraud or false
5 swearing by the insured touching any matter relating to this
6 insurance or the subject thereof, whether before or after a loss.
- 7 **Uninsurable** This policy shall not cover accounts, bills,
8 and currency, deeds, evidences of debt, money,
9 notes or securities; nor, unless specifically
10 **Excepted property.** named hereon in writing, bullion, manu-
11 scripts, mechanical drawings, dies or patterns.
- 12 **Hazards not** This Company shall not be liable for loss
13 **covered.** or damage caused directly or indirectly by
14 invasion, insurrection, riot, civil war or
15 commotion, or military or usurped power, or by order of any
16 civil authority; or by theft; or by neglect of the insured to use
17 all reasonable means to save and preserve the property at and
18 after a fire or when the property is endangered by fire in
19 neighboring premises.
- 20 This entire policy shall be void, unless otherwise provided
21 by agreement in writing added hereto,
- 22 **Ownership, etc.** (a) if the interest of the insured be other than
23 unconditional and sole ownership; or (b) if
24 the subject of insurance be a building on ground not owned by
25 the insured in fee simple; or (c) if, with the knowledge of the
26 insured, foreclosure proceedings be commenced or notice given
27 of sale of any property insured hereunder by reason of any mort-
28 gage or trust deed; or (d) if any change, other than by the death
29 of an insured, take place in the interest, title or possession of
30 the subject of insurance (except change of occupants without
31 increase of hazard); or (e) if this policy be assigned before a loss.
- 32 Unless otherwise provided by agreement in writing added
33 hereto this Company shall not be liable for loss or damage
34 occurring
- 35 **Other insurance.** (a) while the insured shall have any other
36 contract of insurance, whether valid or not,
37 on property covered in whole or in part by this policy; or
- 38 (b) while the hazard is increased by any
39 **Increase of hazard.** means within the control or knowledge of
40 the insured; or
- 41 **Repairs, etc.** (c) while mechanics are employed in building,
42 altering or repairing the described premises
43 beyond a period of fifteen days; or
- 44 **Explosives,** (d) while illuminating gas or vapor is gener-
45 **gas, etc.** ated on the described premises; or while
46 (any usage or custom to the contrary not-
47 withstanding) there is kept, used or allowed on the described
48 premises, fireworks, greek fire, phosphorus, explosives, benzine,
49 gasoline, naphtha or any other petroleum product of greater
50 inflammability than kerosene oil, gunpowder exceeding twenty-
51 five pounds, or kerosene oil exceeding five barrels; or

- 52 **Factories.** (e) if the subject of insurance be a manufac-
 53 turing establishment while operated in
 54 whole or in part between the hours of ten P. M. and five A. M.
 55 or while it ceases to be operated beyond a period of ten days; or
 56 **Unoccupancy.** (f) while a described building, whether in-
 57 tended for occupancy by owner or tenant, is
 58 vacant or unoccupied beyond a period of ten days; or
 59 **Explosion,** (g) by explosion or lightning, unless fire
 60 **Lightning.** ensue, and, in that event, for loss or dam-
 61 age by fire only.
- 62 **Chattel mortgage.** Unless otherwise provided by agreement in
 63 writing added hereto this Company shall
 64 not be liable for loss or damage to any property insured here-
 65 under while incumbered by a chattel mortgage, and during the
 66 time of such incumbrance this Company shall be liable only
 67 for loss or damage to any other property insured hereunder.
- 68 **Fall of building.** If a building, or any material part thereof,
 69 fall except as the result of fire, all insurance
 70 by this policy on such building or its contents shall immediately
 71 cease.
- 72 **Added Clauses.** The extent of the application of insurance
 73 under this policy and of the contribution to
 74 be made by this Company in case of loss or damage, and any
 75 other agreement not inconsistent with or a waiver of any of
 76 the conditions or provisions of this policy, may be provided for
 77 by agreement in writing added hereto.
- 78 **Waiver.** No one shall have power to waive any pro-
 79 vision or condition of this policy except such
 80 as by the terms of this policy may be the subject of agreement
 81 added hereto, nor shall any such provision or condition be held
 82 to be waived unless such waiver shall be in writing added hereto,
 83 nor shall any provision or condition of this policy or any for-
 84 feiture be held to be waived by any requirement, act or proceed-
 85 ing on the part of this Company relating to appraisal or to any
 86 examination herein provided for; nor shall any privilege or per-
 87 mission affecting the insurance hereunder exist or be claimed by
 88 the insured unless granted herein or by rider added hereto.
- 89 **Cancellation** This policy shall be cancelled at any time
 90 **of policy.** at the request of the insured, in which case
 91 the Company shall, upon demand and sur-
 92 render of this policy, refund the excess of paid premium above
 93 the customary short rates for the expired time. This policy
 94 may be cancelled at any time by the Company by giving to the
 95 insured a five days' written notice of cancellation with or with-
 96 out tender of the excess of paid premium above the pro rata
 97 premium for the expired time, which excess, if not tendered,
 98 shall be refunded on demand. Notice of cancellation shall state
 99 that said excess premium (if not tendered) will be refunded on
 100 demand.
- 101 **Pro rata liability.** This Company shall not be liable for a
 102 greater proportion of any loss or damage

103 than the amount hereby insured shall bear to the whole
 104 insurance covering the property, whether valid or not and
 105 whether collectible or not.

106 **Noon.** The word "noon" herein means noon of
 107 standard time at the place of loss or damage.

108 **Mortgage** If loss or damage is made payable, in whole
 109 **interests.** or in part, to a mortgagee not named herein
 110 as the insured, this policy may be cancelled

111 as to such interest by giving to such mortgagee a ten days'
 112 written notice of cancellation. Upon failure of the insured to
 113 render proof of loss such mortgagee shall, as if named as insured
 114 hereunder, but within sixty days after notice of such failure, ren-
 115 der proof of loss and shall be subject to the provisions hereof as
 116 to appraisal and times of payment and of bringing suit. On pay-
 117 ment to such mortgagee of any sum for loss or damage here-
 118 under, if this Company shall claim that as to the mortgagor or
 119 owner, no liability existed, it shall, to the extent of such pay-
 120 ment be subrogated to the mortgagee's right of recovery and
 121 claim upon the collateral to the mortgage debt, but without
 122 impairing the mortgagee's right to sue; or it may pay the mort-
 123 gage debt and require an assignment thereof and of the mortgage.
 124 Other provisions relating to the interest and obligations of such
 125 mortgagee may be added hereto by agreement in writing.

126 **Requirements in** The insured shall give immediate notice, in
 127 **case of loss.** writing, to this Company, of any loss or
 128 damage, protect the property from further

129 damage, forthwith separate the damaged and undamaged
 130 personal property, put it in the best possible order, furnish a
 131 complete inventory of the destroyed, damaged and undamaged
 132 property, stating the quantity and cost of each article and the
 133 amount claimed thereon; and, the insured shall, within sixty
 134 days after the fire, unless such time is extended in writing by
 135 this Company, render to this Company a proof of loss, signed
 136 and sworn to by the insured, stating the knowledge and belief
 137 of the insured as to the following: the time and origin of the fire,
 138 the interest of the insured and of all others in the property, the
 139 cash value of each item thereof and the amount of loss or damage
 140 thereto, all incumbrances thereon, all other contracts of in-
 141 surance, whether valid or not, covering any of said property,
 142 any changes in the title, use, occupation, location, possession, or
 143 exposures of said property since the issuing of this policy, by
 144 whom and for what purpose any building herein described and
 145 the several parts thereof were occupied at the time of fire; and
 146 shall furnish a copy of all the descriptions and schedules in all
 147 policies and if required, verified plans and specifications of any
 148 building, fixtures or machinery destroyed or damaged. The
 149 insured, as often as may be reasonably required, shall exhibit
 150 to any person designated by this Company all that remains of
 151 any property herein described, and submit to examinations
 152 under oath by any person named by this Company, and
 153 subscribe the same; and, as often as may be reasonably

154 required, shall produce for examination all books of account,
155 bills, invoices, and other vouchers, or certified copies thereof,
156 if originals be lost, at such reasonable time and place as may
157 be designated by this Company or its representative, and shall
158 permit extracts and copies thereof to be made.

159 **Appraisal.** In case the insured and this Company shall
160 fail to agree as to the amount of loss or
161 damage, each shall, on the written demand of either, select
162 a competent and disinterested appraiser. The appraisers
163 shall first select a competent and disinterested umpire; and
164 failing for fifteen days to agree upon such umpire then, on
165 request of the insured or this Company, such umpire shall be
166 selected by a judge of a court of record in the state in which
167 the property insured is located. The appraisers shall then
168 appraise the loss and damage stating separately sound value
169 and loss or damage to each item; and failing to agree, shall
170 submit their differences only, to the umpire. An award in
171 writing, so itemized, of any two when filed with this Company
172 shall determine the amount of sound value and loss or
173 damage. Each appraiser shall be paid by the party selecting
174 him and the expenses of appraisal and umpire shall be paid
175 by the parties equally.

176 **Company's** It shall be optional with this Company to
177 **options.** take all, or any part, of the articles at the
178 agreed or appraised value, and also to
179 repair, rebuild, or replace the property lost or damaged with
180 other of like kind and quality within a reasonable time, on
181 giving notice of its intention so to do within thirty days
182 after the receipt of the proof of loss herein required; but
183 there can be no abandonment to this Com-
184 **Abandonment.** pany of any property.

185 **When loss** The amount of loss or damage for which
186 **payable.** this Company may be liable shall be pay-
187 able sixty days after proof of loss, as herein
188 provided, is received by this Company and ascertainment of
189 the loss or damage is made either by agreement between the
190 insured and this Company expressed in writing or by the
191 filing with this Company of an award as herein provided.

192 **Suit.** No suit or action on this policy, for the
193 recovery of any claim, shall be sustainable
194 in any court of law or equity unless all the requirements of
195 this policy shall have been complied with, nor unless com-
196 menced within twelve months next after the fire.

197 **Subrogation.** This Company may require from the insured
198 an assignment of all right of recovery
199 against any party for loss or damage to the extent that pay-
200 ment therefor is made by this Company.

ASSIGNMENT OF INTEREST BY ASSURED

The interest of as owner of the property covered by this Policy is hereby assigned to subject to the consent of the Insurance Company, of N. Y.

[Signature of the Assured.]

Dated, 19.....

CONSENT BY COMPANY TO ASSIGNMENT OF INTEREST

The Insurance Company, of N. Y., hereby consents that the interest of as owner of the property covered by this Policy be assigned to

Agent.

Dated 19.....

FORM FOR REMOVAL

Permission is hereby granted to remove the property insured by this Policy to the situate

and this Policy is hereby made to cover the same property in new locality, all liability in former locality to cease from this date.

Rate increased to % Additional Premium \$.....

Rate reduced to % Return Premium \$.....

Agent.

Date, 19.....

SHEET..... BLOCK..... No.....

No. of Policy
No. of Renewal
Amount Insured

Receipt for Return Premium

To be Signed by the Assured

..... Agency 19..

IN CONSIDERATION OF

..... Dollars, return premium, receipt of which is hereby acknowledged, this Policy is hereby cancelled and surrendered to the Company.

Assured.

	YEAR	MO.	DAY
Date of Cancellation,			
Date of Policy,			
Time in force,			
Premium Paid - - - \$.....			
" earned, - - - \$.....			
" returned, - - \$.....			
If pro-rata, state reason why			

CHAPTER III

THE INSURED—INSURABLE INTEREST AND ASSIGNMENT

Definition and Nature of Insurable Interest.—The fire insurance policy, as already explained, is essentially a personal contract. To eliminate the moral hazard as much as possible, it is important that the insured should have a pecuniary interest in the property which he wishes to insure. Fire insurance policies are contracts for indemnity and not for profit. Where the insured has no insurable interest in the property covered by the policy there can be no loss, and hence no indemnity.

In life insurance, as contrasted with fire insurance, this principle of indemnity has not been defined clearly. Not only do the courts hold that a person has an insurable interest in his own life for any amount for which he may be willing to pay premiums, but as regards the insurable interest of blood relatives in the life of the insured, and, in many states, even as regards the interest of creditors, the tendency has been not to lay down hard and fast rules as to the amount of insurance that may be taken. In fact, most legal authorities do not regard life insurance policies as contracts for indemnity, but view them as agreements for the payment of a definite sum "upon the happening of a certain event at an uncertain time in the future."

"Insurable interest," as applied to fire insurance contracts, has been defined as "every interest in property or in relation thereto or liability in respect thereof, of

such a nature that a contemplated peril may directly damnify the insured.”¹ Every person who has such an insurable interest in property has the right to insure the same under a fire or marine insurance policy. It is to be noted that the definition is exceedingly broad in its scope, and that insurable interest does not necessarily imply ownership or possession of the property. Insurable interest may assume hundreds of forms, and may exist under very different conditions. Elliott briefly summarizes the nature of the interest as follows: “The interest which may be insured must be neither illegal nor immoral. It may be either legal or equitable, but it is not necessary that the party should have either legal or equitable title to the property. The interest may be either conditional or contingent. . . . An insurable interest does not imply ownership of the property or even a right to its possession. A person may insure his interest in expected commissions, or, in what seems an extreme case, an expected catch of fish. But in all such cases an expectation of profit or benefit must arise out of some subject in which the party is actually interested at the time of the loss, and it is not enough that he only expects to be interested in such property.”²

Examples of Insurable Interest.—Space limits forbid a full enumeration of the immense variety of forms that insurable interest in property may assume. Moreover, there is probably no other legal phase of property insurance where there are so many border-line court decisions. The following classification will furnish the most important instances where the weight of legal authority upholds the existence of an insurable interest:

¹ Elliott, “The Law of Insurance,” p. 40.

² Elliott, “The Law of Insurance,” p. 44.

EXAMPLES OF INSURABLE INTEREST

(1) *Ownership or possession:*

Those having legal title to property.

Those having equitable title to property.

Those in possession under an illegal or defective title.

Those in possession, with a claim of title until the same is judicially held invalid.

Lessee, in property held under lease.

Mortgagor, to the full value of property mortgaged.

Partners, in the firm's property.

Part owners, in their respective interests.

Vendee in possession, or when obligated to pay the purchase price.

Vendor, until final transfer takes place.

(2) *Custodians of property entrusted to their care (to the extent of their interest or liability):*

Administrators of estates.

Agents or factors, in property held for principal.

Assignees in insolvency.

Trustees.

Receivers.

Common carriers.

Warehousemen.

Commission merchants.

(3) *Creditor or debtor relations:*

Judgment or attaching creditors.

Mortgagee, to extent of mortgage debt.

Debtors, in property seized for debt.

Endorsers and sureties, in property of the guaranteed.

Pledges, to value of goods held in pledge.

Those who have, with consent, expended money upon other persons property.

(4) *Contract rights whose value depends upon preservation of property:*

Contractors, when payment is deferred until contract is completed.

Consignees of goods.

Consignors of goods.

Patentees, with contract for royalties.

Insurers, in property reinsured.

(5) *Other leading instances:*

Beneficiaries, in property by which they are to benefit.

Stockholders, in the corporate property.

Tenants for life.

So broad, in fact, has been the application of the theory of insurable interest in fire insurance that comparatively few instances are found where all the court cases agree that no insurable interest exists. In the case of parties to void contracts, trespassers, or persons interested in property which cannot be legally owned or operated, the courts with one accord have denied the existence of such an interest. But in many of the doubtful cases, as, for instance, where a remote possibility exists that a right in property may arise, which, however, may be destroyed by the occurrence of some event, or where a person has made voluntary advances, or is only a general creditor, there are found conflicting decisions, some of which concede the existence of an insurable interest, whereas others deny the same.

The Time and Continuity of Insurable Interest.—The weight of early legal decisions is to the effect that a fire insurance policy could only be supported by an insurable interest that existed both when the contract was made as well as at the time of the loss. In more recent years, however, the courts have shown a strong tendency to

view the insurable interest supporting a fire policy as similar to that applying in marine insurance. In that type of insurance it has always been the rule that an insurable interest, existing at some time during the risk and at the time of the loss, is sufficient to uphold the policy, and that it is unnecessary to have the interest exist at the time that the policy was written. The vicissitudes of marine ventures, especially where voyages are long and to remote countries, have made this ruling a necessity. Thus in marine underwriting it has always been a common practice to insure vessels and cargoes "lost or not lost," meaning that even though the property be lost when the policy is written, without, however, the knowledge of the insured, the company will indemnify the owner when information of the loss shall be obtained. Again, it may frequently be convenient for merchants, where long distances are involved and communication is difficult, to insure cargoes before it is definitely known that they have begun the voyage. Freight earnings in marine ventures are also insured against loss before they are earned.

More recent decisions point to the fact that there never was any good reason for making a distinction between fire and marine insurance as regards the necessity of insurable interest at the time of the inception of the policy. Thus in the case of *Sun Insurance Office vs. Merz* (64 N. J., p. 303), the court gives the following explanation: "This was formerly considered to be the rule with relation to fire policies, and was so declared both by text-writers and in decided cases, although a contrary view was always taken in construing life and marine policies. Why any such variance in construction existed, it is difficult to understand, for certainly if a contract to insure after-acquired property against fire is a wagering contract, and therefore void because against public

policy, a contract to insure such property against marine risks, or a contract to insure the life of a person in favor of one who at the time of the taking out of the policy has no interest therein, are equally wagering contracts; and if such contracts are prohibited by public policy, should equally be considered void. But, although the earlier cases on fire insurance laid down the rule enunciated by the Supreme Court, experience has taught that the necessities of business and the adequate protection of property require the same methods of insurance against loss by fire as have always existed with relation to losses by the perils of the sea. And reflection has led to the conclusion that contracts of insurance upon property in which the insured has no interest at the time of the issuance of the policy are not wagers if he acquires an interest during the life of the policy and retains it at the time when the loss occurs."

The question that next suggests itself has reference to the continuity of the interest. Assuming that an insurable interest exists, either at or some time after the issuance of the policy, must this interest continue without a break until the time of the loss, in order to keep the policy in force, or may the interest cease for a time and then be restored without invalidating the insurance? The answer to this question is well presented by Elliott. "In those jurisdictions," he writes, "which hold that the interest need not exist at the time the policy is taken out, it is sufficient if it exists at some time during the risk and at the time of the loss. But policies now generally contain a provision forbidding a change of title or the alienation of the property under a penalty of forfeiture. This provision is effective, but in its absence the contract is merely suspended during the time the interest is gone, and revives to secure the new interest acquired before the loss."³

³ Elliott, "The Law of Insurance," p. 43.

Policy Provisions Relating to Ownership and Interest.

—Having explained the general principles governing insurable interest in fire insurance, attention should next be called to the specific references to the subject contained in the standard policy form. The entire policy is declared to be void unless otherwise provided by agreement in writing added hereto:

“(a) If the interest of the insured be other than unconditional and sole ownership.”—As common examples of conditions which sufficiently change the ownership to avoid the policy, the following five illustrations are mentioned by Barbour:⁴

- “(1) Sale of the property.
- (2) An assignment for the benefit of creditors.
- (3) The appointment of a trustee in bankruptcy, although the appointment of a receiver in bankruptcy is not usually considered a change of ownership.
- (4) If a co-partnership takes in a new partner, but not if one retires instead.
- (5) Contract of sale where vendee is given or takes possession.”

The fundamental purpose of this clause is to assure a clear statement of the insured's insurable interest so as to avoid any moral hazard. That type of hazard would manifestly be increased greatly if all parties interested in a property had the right to insure the same to its full value and to collect that amount, irrespective of the pecuniary loss to which they would actually be subjected by a destruction of the property by fire. It is only fair that the policy should state the insured's actual interest, if it is not sole and unconditional ownership. A common

⁴ Robert P. Barbour: “Agent's Key to Fire Insurance,” p. 67.

method of handling the situation is to state the insured's interest by using the general phrase "as interest may appear."

While the clause under consideration is clearly in the interest of the underwriter, it has received the general support of the courts as being reasonable. The insured is duty bound, by the weight of legal opinion, to give a true statement of his interest in the property covered, despite the fact that the insured may not have requested the information. Encumbrances and liens upon the property, however, need not be revealed by the insured, since their existence in no way deprives him of ownership.

"(b) *If the subject of insurance be a building on ground not owned by the insured in fee simple.*"—Being similar in character to the preceding clause dealing with unconditional and sole ownership, this clause must also be given a similar legal construction. Thus, it has been held that ownership of only part of the fee, or possession of a life estate only, without disclosing these facts to the insurer, constitutes a violation of the clause under consideration.

"(c) *If, with the knowledge of the insured, foreclosure proceedings be commenced or notice given of sale of any property insured hereunder by reason of any mortgage or trust deed.*"—This clause would seem to indicate that it is unnecessary to advise the insurer of the existence of a mortgage on the insured premises until the foreclosure proceedings are actually commenced, or until there is receipt of notice of sale, if the terms of the mortgage allow this in lieu of judicial proceedings. In other words, this clause appears to apply only to the future, and is not affected by mortgages which are pending when the policy is issued. In the absence of the company's written permit, however, the insured's knowledge of foreclosure proceedings, following their commencement but prior to a loss, will invalidate the insurance.

“(d) If any change, other than by the death of an insured, takes place in the interest, title or possession of the subject of insurance (except change of occupants without increase of hazard).”—This clause, commonly known as the “alienation clause,” is extremely broad and simply declares that all such changes must be brought to the attention of the company in order to give it the opportunity of canceling the policy, if an undesirable new party is brought into the insurance contract. Many cases will arise where the courts must pass upon the effectiveness of certain changes in the insured’s title, possession, or interest, and in this connection their attitude has favored the view that only material changes in title or possession of the property should nullify the policy. Thus the appointment of a receiver is not considered, by the weight of legal opinion, such a change in the title or possession of the property as to lead to a forfeiture (136 U. S., 223), since receivers obtain their authority from the court, and their appointment is not made with a view to changing the title or right to possession, but to managing the property for the benefit of those ultimately entitled to the same. Nor will this provision, by the weight of court opinion, be violated by an executory contract of sale, according to the terms of which the vendor retains possession until the purchaser has made all payments; or by any change whereby the interest of the insured in the property is increased; or by an invalid sale of property; or by a transfer between partners or trustees without bringing any new owner into the property insured.

The policy wording is also such as clearly to imply that the clause is not intended to work a forfeiture in the case of the transfer of the insured property, by the death of the insured, to his heirs or other representatives. By the weight of opinion, the provision against the transfer or change of the insured’s title is invalidated through the

conveyance of an undivided interest in the property, although the amount of insurance happens to be considerably less than the remaining interest of the insured in the property. Similarly, the clause is violated when the purchaser of the property, before completing his executory contract, has taken possession and control of the insured property.

“(e) If this policy be assigned before a loss.”

Provision against the existence of chattel mortgages.—

It is noteworthy that the fire insurance policy specifically requires a disclosure of chattel mortgages. The policy reads: “Unless otherwise provided by agreement in writing added hereto this Company shall not be liable for loss or damage to any property insured hereunder while encumbered by a chattel mortgage, and during the time of such encumbrance this Company shall be liable only for loss or damage to any other property insured hereunder.”

The foregoing clause is upheld by the courts, although, generally speaking, the existence of a chattel mortgage is not regarded, to quote the policy, as a “change of interest, title or possession of the subject of insurance” or an “increase of hazard.” From the insurance company’s standpoint, personal property, owing to its movable nature, is much more hazardous than realty. Moreover, this type of mortgage is often indicative of the mortgagor’s limited financial resources.

Assignment of Fire Policies.—*Assignment before loss without company’s consent prohibited.*—The fire policy, as explained previously, is essentially a personal contract and insures the owner of the property rather than the property itself. It is for this reason that the standard policy provides: “This entire policy shall be void, unless otherwise provided by agreement in writing added hereto, if this policy be assigned before a loss.” This clause is necessary and reasonable as a precautionary measure against fraud.

It often happens that companies, following an assignment made contrary to the aforementioned policy provision, consent to the continued validity of the contract when they are satisfied with the character of the parties concerned. But the frequent extension of such acts of grace to the insured should not be interpreted as creating a general usage which tends to compel the company to accept the assignee. In life insurance the courts of many states have decided that, in the absence of restrictive policy provisions, the policy is assignable. But in fire insurance, on the contrary, it is a well-established legal principle that the policy, since it is a personal contract, can be assigned before a loss only with the consent of the company. In case of the transfer of the insured property by sale, the company, for example, may refuse its consent to the transfer of the policy, and will be relieved of all further liability.

Form of the Company's Endorsement Acknowledging Consent to Assignment.—The policy form usually provides two assignment blanks on the reverse side, which must be properly filled by the insured and insurer to effect an assignment. It should be explained that companies do not regard the partial assignment of a policy with favor. As pointed out by Barbour:⁵ "It is rarely advisable to partially assign a policy, as for example, where it covers on a dwelling and on household furniture therein and the dwelling is sold. Either cancel and re-write under two policies, one for each owner, or cancel the amount covering on the property sold, and write a new policy thereon in the name of the new owner."

⁵ Robert P. Barbour: "Agent's Key to Fire Insurance," p. 44

(SAMPLE ASSIGNMENT FORM)

ASSIGNMENT OF INTEREST BY INSURED

The interest of ... *John Doe* ... as owner of the property covered by this policy is hereby assigned to *Richard Roe* subject to the consent of the *Sam Fire Ins.* Company.

.....
John Doe
 [Signature of the insured]

Date ... *Jan. 22, 1912*

CONSENT BY COMPANY TO ASSIGNMENT OF INTEREST

The, *Sam Fire* Company hereby consents that the interest of ... *John Doe* as owner of the property covered by this policy be assigned to ... *Richard Roe*

.....
 [Signature for company]

Date ... *Feb. 1, 1912*

Assignment When There Has Been a Transfer of the Property.—In discussing the legal nature of an assignment of a fire policy it is essential to distinguish between those cases where there is an actual transfer of the property and those where there is not. Thus where a policy is assigned to a mortgagee as his interest may appear, the mortgagee, as will be explained more fully in the next chapter, is not absolutely protected. In law the mortgagor is still regarded as the owner of the property and the insured, and it is, therefore, his conduct which will control the validity of the policy. The policy may be valid at the time of assignment to the mortgagee, but, unless court or statute law prohibits, may be rendered null and void thereafter by the mortgagor's improper conduct. Or, the mortgagor may already have violated the policy so as to make it void at the time of the assignment in which case he cannot convey to the mortgagee more than he himself possesses, namely, an invalid policy, and the mortgagee, as assignee, cannot receive more than the mortgagor was

in a position to give. To overcome this obstacle it is the general practice of companies to protect the mortgagee by indorsing on the policy a so-called "mortgagee clause" which promises to indemnify him as his interest appears, and especially provides that he shall be protected against any act on the part of the mortgagor which may invalidate the insurance.

Where, however, there has been an actual transfer of the title, and the policy has been assigned with the company's consent, it is the general rule to view the assignment as constituting a new and independent contract between the assignee and the company. The assignee will thus be protected against the acts of the original policyholder, and this is true even though the company lacked knowledge of some act of the assignor violating the policy conditions. With the transfer of the policy by assignment, consented to by the company, the purchaser is considered by the courts to be protected in the same way as if the company had reissued to him a new policy, similar in all respects to the policy held by the person originally insured. Ostrander, in summarizing the various legal decisions which define the character of an assignment where there is a transfer of the property, gives the following explanation: "The assignment in such case has no other legal effect than to acquit the company as to the party first insured. This might be done in a different, and perhaps better, form, but the method chosen is sufficient to accomplish the object sought. It is a short, simple process to release the insurer as to one party, and bind it as to the other. In *Continental Insurance Co. vs. Munns* (120 Ind., 30; 22 N. E., 781) the property had been mortgaged in violation of the conditions of the policy, which was subsequently assigned, on sale of the property, with the consent of the company, who had no knowledge of the forfeiture occasioned by this circumstance. The court

said 'that the policy expires with the transfer of the estate, so far as it relates to the original holder; but the assignment and consent of the company constitute an independent contract with the assignee, the same in effect as if the policy had been reissued upon terms and conditions therein expressed. . . . The contract of insurance thus consummated arises directly between the purchaser and the insurance company, to all intents and purposes the same as if a new policy had been issued, embracing the terms of the old. In such a case no defense predicated on the supposed violations of conditions of the policy by the assignor will be available against the assignee.' ''⁶

Pledging of Policy as Collateral Security not Prohibited by Assignment Clause.—Unless provided in the policy to the contrary, it is the general rule that a pledging of the policy as collateral security will not invalidate the contract, even though this may have been done without the company's knowledge or consent. The assignor continues in this case to be the owner of the property and is still the insured, although the assignee has a lien on the proceeds of the insurance which will protect him in preference to other creditors. As Richards summarizes the proposition:⁷

"Where the policy has been transferred as collateral security either with or without the consent of the insurer, the assignee may be merely an appointee or payee to receive any insurance money to the extent of the debt. In such a case it is not necessary that he should show any title or insurable interest in the property itself. An equitable assignee of the proceeds of insurance, if any, need have no interest in the property itself."

⁶ Ostrander on "Fire Insurance," pp. 502, 503. This decision represents the great weight of authority, although there are some decisions to the contrary.

⁷ Richards: "Treatise on the Law of Insurance," p. 354.

Assignment After the Occurrence of a Loss.—A clear distinction must be made between the policy and the proceeds obtained on the same after a fire has caused a loss. The policy itself cannot be assigned without the company's consent, but a claim for loss or damage may be thus assigned. Again quoting Richards: ⁸

“After a loss by fire has occurred, the claim of the assured for damages is a *chose in action*, which he has a right to assign in spite of this clause, without asking permission of the company, and the assignee then takes, subject to all defenses available to the insurer as against the assignor. But any excess of insurance over and above the fire loss still belongs to the assured assignor, and he can no more assign the policy as to that without consent than he could do so before the fire.”

⁸ *Ibid.*, p. 355.

CHAPTER IV

THE MORTGAGEE CLAUSE

Mortgagee and Mortgagor Have Separate Insurable Interests.—One of the most common cases where more than one party has an insurable interest in the same property arises in connection with the mortgagee's interest.¹ The courts fully recognize the principle that both mortgagor and mortgagee possess an interest in the mortgaged property which each may insure separately, without violating the policy provision against double insurance. The mortgagor, as owner of the property, may insure the same to the extent of its value, and the mortgagee, as creditor, may effect insurance to the extent of his interest. Both parties may secure insurance without consulting each other, or without giving notice to or receiving the consent of the other insurer. In brief, the courts regard the two insurances as covering separate insurable interests, and hold that where the mortgagee has taken out a policy in his own name and pays the premium, the mortgagor is to be considered a stranger to the contract.


At least five methods are available to protect the mortgagee's interest. Some of these have proved very

¹ The reader's attention is called to the article by Robert Riegel on "Protection of a Mortgagee's Interest in Real Property by Insurance." *Journal of Political Economy*, Volume 33, December, 1915.

deficient from the viewpoint of the mortgagee's protection, and it is owing chiefly to these deficiencies that the so-called "mortgagee clause" has had its origin. The five methods referred to are:

The Mortgagee May Insure His Own Interest.—When the mortgagee insures his interest in his own name, the mortgagor in no way has an interest in the benefits derived from the insurance and the indemnity paid cannot be applied to the payment of the mortgage debt. Now if the mortgagor is not relieved from his debt and the mortgagee is entitled to the proceeds of his policy, it would seem that the mortgagee might receive two payments for one debt. This would manifestly be contrary to justice, and would give rise to fraud.

To avoid such double payments, it is a well-established legal principle that upon the payment of a loss to the mortgagee the insurer becomes subrogated to the mortgage or other evidence of debt, i.e., becomes entitled to all the rights which the mortgagee had in the mortgage. If the insurer, now the holder of the mortgage, can collect the same when it matures, he will be reimbursed. But in case this cannot be done, the insurer and not the mortgagee will be the loser. If the loss is less than the sum to which the mortgagee is entitled, the company is subrogated to the right to collect the loss, but in this case it should be noted that the company's rights are subordinate to those of the mortgagee. If, after a loss has been paid, there still remains a portion of the property, the company cannot prejudice the mortgagee's right to this security and the collection of the balance of the debt. The company is subrogated to so much of the mortgage as it has paid, and is only entitled to such portion of the remaining property as will not be needed to protect the mortgagee's interest in the balance of the debt not yet paid.



Two methods of settling a loss present themselves when the mortgagee has insured his own interest. Thus let us assume that "M" (the mortgagee) holds a mortgage of \$10,000 on "X's" (the mortgagor's) property, valued at \$12,000, and has insured his interest in Company "Y." Assume also that a loss of \$9,000 occurs. Under one method of settlement, and by far the most commonly used, Company Y pays M the full \$10,000 and becomes subrogated to that amount. Under another method, Company Y pays M the amount of the loss (\$9,000) and becomes subrogated to M's right to collect that sum from X at the maturity of the mortgage. M, however, retains the right to collect the balance due (\$1,000), and may not be prejudiced by Company Y in this respect. Should Y succeed in collecting the \$9,000 from X, it will have been fully reimbursed for the loss paid to M. Should it happen, however, that foreclosure becomes necessary and that the property sells for less than is required to meet Company Y's claim for \$9,000, and M's balance due for \$1,000, Company Y must be the loser.

Instances of insurance by the mortgagee in his own name are comparatively rare. This method affords full protection to the mortgagee, it is true, and may be utilized where he lacks confidence in the mortgagor's policy and thus desires insurance of his own choosing. But as opposed to this, there is the disadvantage to the mortgagee of paying the premium. The insurer, likewise, dislikes the method, because of the difficulty of supervising the risk and the possibility of fraudulent collusion between mortgagor and mortgagee.

Mortgagee May Take the Mortgagor's Policy by Way of Assignment.—While the mortgagee's interest may be insured directly and separately, it is the desire of the insurer to avoid this wherever possible. Companies much prefer to issue the policy in the name of the owner,

i.e., the mortgagor, and thus join the two interests. This will enable the company to maintain a better supervision over the policy, will reduce the possibilities of fraud, and will eliminate the complications which may arise when the two interests are insured in different companies.

Various methods may be used to accomplish this result, but nearly everywhere all have given way to the so-called "mortgagee clause." The mortgagor may, for example, take the policy in his own name, and assign it to the mortgagee on a form similar to that discussed in the preceding chapter under the subject of "Assignment." This method, however, is dangerous to the mortgagee, because the validity of the policy, when an assignment is made without an actual transfer of the property, will depend upon the mortgagor's acts or neglect. In law the mortgagor is still the policyholder, and as such his acts or omissions may cause a forfeiture of the policy. The protection of the mortgagee is thus dependent upon the conduct of the mortgagor, over whom he may not be able to exercise any supervisory control. Again, if the mortgagor has violated the policy and a forfeiture exists at the time of the assignment, the mortgagee's interest is unprotected, because in making the assignment the assignor can give only what he possesses, i.e., in this case an invalid policy. It should also be noted that the mortgagee is not a contracting party to the policy. Accordingly, he enjoys no legal rights with respect to participation in any negotiations after a loss, such as an appraisal or other method of settling a claim. Should the mortgagor and his insurer agree upon an inadequate valuation for settlement purposes, the mortgagee would be helpless under this method to undo the arrangement.

Mortgagor's Policy Endorsed "Loss, if any, Payable to Mortgagee as His Interest May Appear."—Under this plan the policy contains the following endorsement:

"Loss, if any, payable to ... *John Doe* Mortgagee, as *his* interest may appear, subject nevertheless to all the conditions of this policy." The effectiveness of this clause, commonly called "the loss payable clause," has been variously interpreted by the courts. In one group of states the clause is construed as simply making the mortgagee a representative of the mortgagor to receive the proceeds of the policy. Under this interpretation, the method is, therefore, subject to all the objections already noted in connection with an ordinary assignment. In a limited number of states, however, the endorsement is interpreted as an independent and unconditional agreement between mortgagee and insurer. Under such circumstances the plan proves highly advantageous to the mortgagee, since he is given all of the mortgagor's rights, without being bound by either his acts or the conditions of the policy.

The "Mortgagee Clause."—To join the two interests in the same policy and be just to the mortgagee, it is essential that he be protected against a forfeiture of the policy through the acts or neglect of the owner of the property. This is done to-day by means of the widely used "mortgagee clause." The mortgagor takes out the policy in his own name, and to protect the mortgagee's interest a special clause is endorsed on the contract, according to which the company agrees to protect his interest as it may appear, regardless of the conduct of the mortgagor as concerns the provisions of the policy. The following is a leading form of the clause:

COPY OF MORTGAGEE CLAUSE

Loss or damage, if any, under this policy, shall be payable to ... *John Doe* as *John Doe* mortgagee (or trustee) as interest may appear, and this

insurance, as to the interest of the mortgagee (or trustee) only therein, shall not be invalidated by any act or neglect of the mortgagor or owner of the within described property, nor by any foreclosure or other proceedings or notice of sale relating to the property, nor by any change in the title or ownership of the property, nor by the occupation of the premises for purposes more hazardous than are permitted by this policy. PROVIDED, that in case the mortgagor or owner shall neglect to pay any premium due under this policy, the mortgagee (or trustee) shall, on demand, pay the same.

PROVIDED, also, that the mortgagee (or trustee) shall notify this company of any change of ownership or occupancy or increase of hazard which shall come to the knowledge of said mortgagee (or trustee) and, unless permitted by this policy, it shall be noted thereon, and the mortgagee (or trustee) shall, on demand, pay the premium for such increased hazard for the term of the use thereof; otherwise this policy shall be null and void.

This company reserves the right to cancel this policy at any time as provided by its terms, but in such case this policy shall continue in force for the benefit only of the mortgagee (or trustee) for ten days after notice to the mortgagee (or trustee) of such cancellation, and shall then cease, and this company shall have the right, on like notice, to cancel this agreement.

Whenever this company shall pay the mortgagee (or trustee) any sum for loss or damage under this policy and shall claim that, as to the mortgagor or owner, no liability therefor existed, this company shall, to the extent of such payment, be thereupon legally subrogated to all the rights of the party to whom such payment shall be made, under all securities held as collateral to the mortgage debt, or may, at its option, pay to the mortgagee (or trustee) the whole principal due or to grow due on the mortgage with interest, and shall thereupon receive a full assignment and transfer of the mortgage and of all such other securities; but no subrogation shall impair the right of the mortgagee

(or trustee) to recover the full amount of *his*
claim.

Dated

Attached to and forming part of Policy No.
of the (Name of Company).

.....
Signature of the Company.

Reference should be made to the fact that fire policies frequently contain considerable sections of the so-called mortgage clause. Thus the New York standard policy (lines 108 to 125) incorporates those portions of the mortgagee clause which relate to notice of cancellation and to subrogation in the event of the payment of a loss to the mortgagee when the company denies that any liability exists in favor of the mortgagor. The policy makes further provision for the mortgagee's responsibility for proofs of loss, appraisal, and bringing of suit, as provided by the terms of the policy, in the event that the mortgagor fails in these respects. Further provision is made that "other conditions relating to the interest and obligations of such mortgagee may be added hereto by agreement in writing."

Advantages of the Mortgage Clause.—By endorsing the above clause on the mortgagor's policy, the company specifically agrees that the protection of the mortgagee's interest shall not be invalidated by the acts or neglect of the owner of the property. Such endorsement also results (1) in making the mortgagee a party to the contract and giving him a legal right therein, and (2) in freeing him from those policy provisions which go into effect after a loss has occurred. With respect to such provisions, however, the policy itself, or the clause indorsed thereon, may contain a different provision establishing the liability of the mortgagee. Thus, the New York standard form stipulates: "Upon failure of the insured to render proof of loss such

mortgagee shall, as if named as insured hereunder, but within 60 days after notice of such failure, render proof of loss, and shall be subject to the provisions hereto as to appraisal and times of payment and of bringing suit." Compared with other available methods, the disadvantages of the mortgagee clause are few. In fact, they are chiefly confined to the few states where the "loss payable clause" has been interpreted as an independent and unconditional agreement between mortgagee and insurer.

Analysis of the Clause.—*Payment of loss to mortgagee.* ✓

—In the event of loss most companies follow the practice of making settlement by draft payable both to the mortgagee and the mortgagor, and release from both parties is thus obtained. As an illustration of the method of settlement, let us assume that "X" (the mortgagor) owns a property valued at \$12,000 and that "M" (a mortgagee) holds a mortgage against the property for \$10,000. Also assume that "X" protects "M" with a standard mortgagee clause indorsed on a \$10,000 policy issued by Company "Y." In the event of a \$5,000 loss, Company "Y" will pay that amount by a draft payable to both "M" and "X." The mortgagor (the insured), it is clear, should be protected under the policy, since he has in no way violated any of its provisions. Upon receipt of the joint draft, "M" and "X" may arrange either to have "X" receive the \$5,000 and continue as mortgagor for the full original mortgage, or to have "M" receive the \$5,000 and have him credit "X" with that sum in liquidation of the mortgage debt. The mortgagee, however, is entitled to the loss if no other arrangement can be effected. In that case "X's" mortgage, as already pointed out, will be credited with the \$5,000 payment. Or Company "Y" might pay "M's" mortgage of \$10,000 and become subrogated to the right to collect the balance over and above the loss (viz., \$5,000) from "X" at the maturity of the mortgage.

Where there are several mortgagees on the same property, and each is protected by a separate policy containing a mortgagee clause, it becomes desirable to state the rights of each mortgagee, on the assumption that any loss payment to the mortgagee will reduce the mortgage accordingly. This is desirable in the interest of enabling the companies to avoid payments in excess of the loss actually incurred. Two methods have been suggested, namely, (1) make the "loss payable to, first mortgagee, and, second mortgagee, as interest may appear"; and (2) make the "loss payable to, first mortgagee, as interest may appear, and remainder, if any, to, second mortgagee."

Mortgagee's interest not invalidated by act or neglect of mortgagor.—Should the mortgagee know of the violation of the policy at the time of the endorsement of the mortgagee clause, the probability is that the contract will also be void as to the mortgagee. Such is not the case, however, if the mortgagee acquires knowledge of the violation of the policy subsequent to the endorsement of the clause, except as regards "change of ownership or occupancy or increase of hazard." But the question may be asked: Does a mortgagee clause, attached to an invalid policy, not known to be such by the mortgagee, revive said policy back into life? Here there is a conflict of opinion. In certain states the mortgagee is regarded as protected from the consequences of the acts of the mortgagor, whether committed prior or subsequent to the endorsement of the clause on the policy. In other states, however, a less favorable view prevails, and the mortgagee is held to be protected only against the acts of the mortgagor following the endorsement.

Mortgagee liable for the premium.—Reference need merely be made to the two sections of the clause relat-

ing to this matter. One provides that "in case the mortgagor or owner shall neglect to pay any premium due under this policy, the mortgagee (or trustee) shall, on demand, pay the same." The other section provides that "if change of ownership or occupancy or increase of hazard shall come to the knowledge of said mortgagee (or trustee) and, unless permitted by this policy, it shall be noted thereon and the mortgagee (or trustee), shall, on demand, pay the premium for such increased hazard for the term of the use thereof."

Cancellation of the mortgagee's protection.—The company reserves the right "to cancel this policy at any time as provided by its terms, but in such case this policy shall continue in force for the benefit only of the mortgagee (or trustee) for 10 days after notice to the mortgagee (or trustee) of such cancellation, and shall then cease, and this company shall have the right on like notice, to cancel this agreement." It should be noted that the interest of the mortgagee may be terminated in two ways, namely, (1) by cancellation of the policy, or (2) by cancellation of the mortgagee clause. In either case the mortgagee is entitled to 10 days' notice as contrasted with the 5 days' notice extended to the mortgagor under the terms of the policy.

Subrogation when mortgagor violates policy.—Should the company pay a loss to the mortgagee and at the same time claim that no liability exists to the mortgagor, the company reserves the right, under the mortgagee clause, to be legally subrogated, to the extent of the payment made, "to all the rights of the party to whom such payment shall be made, under all securities held as collateral to the mortgage debt, or may, at its option, pay to the mortgagee (or trustee) the whole principal due or to grow due on the mortgage with interest, and shall thereupon receive a full assignment and transfer of the mortgage and of all such

other securities." But the clause expressly provides that in no case shall the subrogation "impair the right of the mortgagee (or trustee) to recover the full amount of claim."

Special or Blanket Agreements.—Many special arrangements are effected between insurance companies and mortgagees. But special attention should be called to a type of blanket agreement whereby the insurance company undertakes to protect the mortgagee, usually large lending institutions like life insurance and trust companies, against all adverse legal contingencies. In certain localities, as already observed, some doubt exists as to the legal effect of a mortgagee clause when attached to a policy already null and void because of violation by the mortgagor. The aforementioned blanket agreement is designed to overcome this as well as any other legal doubts. In brief, the company agrees by such special arrangements to protect the mortgagee's interest by waiving its rights to contest the validity of the policy.

Contribution Under the Mortgagee Clause.—As will be explained more fully in a later chapter, the standard policy provides that in case several policies have been written on the same property, each company will only pay that part of any loss which is represented by the proportion that its policy bears to the total insurance granted under all the policies. It may happen that where a number of policies have been written in the name of the owner of the property, he may subsequently make one or more of these policies payable to a mortgagee under the usual mortgagee clause, promising to protect the mortgagee's interest, regardless of any acts or neglect of the owner. Under such circumstances the question arises as to how a loss shall be apportioned among the several policies covering the property.

This subject was carefully discussed by the New York

Court (73 N. Y., 141). Here the owner of the insured building had secured two policies in different companies, one for \$4,000 in the Lycoming Company, and the other for \$10,000 in the Westchester Company. The mortgagee held a mortgage on the premises for \$14,000, and with the consent of the Company had his interest protected under a mortgagee clause indorsed on the policy issued by the Westchester Company and offering protection against the acts or neglect of the owner. Although the policies provided for the apportionment of the loss in case other insurance existed, the mortgagee clause itself did not contain any agreement as to contribution. A loss of \$9,000 occurred and the Lycoming Company, in accordance with the terms of its policy, which provided for the payment of any loss in the proportion that its policy bore to all the insurance on the property, promptly settled for \$2,571.43, or four-fourteenths of the \$9,000 loss, i.e., in the proportion that its policy of \$4,000 bore to the total insurance of \$14,000. The Westchester Company, whose policy also contained the same apportionment clause, insisted on paying only the balance of the loss, or ten-fourteenths. To this, however, the mortgagee objected on the ground that if this were permitted his interest under the mortgagee clause would suffer.

In deciding the case the court expressly declared that the mortgagee clause, when indorsed on the policy, constituted an independent contract between the mortgagee and the Westchester Company. The mortgagee had a right to feel that his interest was protected under this independent agreement, especially since he had no interest in the Lycoming policy. The court therefore ordered payment of the loss to the mortgagee in the same manner as would have been the case if there had been no second policy.

In view of such rulings as the above, it is customary

to-day, if the company wishes to retain the privilege of apportioning its loss among all the policies on a given property, to obviate all legal complications by inserting a "contribution clause" in the mortgagee clause. Thus, in New York and other states two forms of standard mortgagee clauses are used, one being called the "non-contribution mortgagee clause," and the other the "full contribution mortgagee clause." The latter is just like the clause already discussed, except for an additional provision which reads as follows:

"In case of any other insurance upon the within described property this company shall not be liable under this policy for a greater proportion of any loss or damage sustained than the sum hereby insured bears to the whole amount of insurance on said property, issued to or held by any party or parties having an insurable interest therein, whether as owner, mortgagee or otherwise."

Although the wording of this "contribution clause" would seem to be sufficiently definite to preclude a misunderstanding, there have been conflicting decisions as to its effectiveness when the mortgagor, after protecting the mortgagee under a mortgagee clause providing for full contribution, takes out subsequent insurance of which the mortgagee had no knowledge. In the case of *Eddy vs. London Assurance Corporation* (143 N. Y., 311) the owner of the property had taken out insurance for the protection of the mortgagee. The mortgagee clause protected the mortgagee against the acts of the owner, and contained the contribution clause as quoted above. Subsequently, and for his sole benefit, and without the mortgagee's consent or knowledge, the owner procured other insurance that was not made payable to the mortgagee. Upon a loss occurring, the companies issuing the policies made payable to the mortgagee insisted on the right of

paying only that portion of the loss represented by their pro rata share of all the insurance on the property, even though taken out subsequently to the issuance of the mortgagee clause and for the sole benefit of the owner.

The court argued that in this particular case the "full contribution clause" in the mortgagee clause was inconsistent with the other section in the same clause which protects the mortgagee against the acts of the owner, and that this last agreement must take precedence over the provision for contribution. Since the last policies were taken out by the owner for his own benefit and without the knowledge of the mortgagee, the court argued that "the act of obtaining this additional insurance was the act of the owner, and it was unknown to the mortgagee, and, of course, not consented to by him. The additional insurance could by no possibility benefit him, as it was not upon any interest of his in the property. He could not, therefore, resort to any of these additional policies for his indemnity. It is not a case of contribution in any sense, but simply one on the insurer's theory of the diminution of their liability, caused by the act of the owner, and unknown, and with no possible corresponding benefits, to the mortgagee." While legal textbook writers recognize the force of this reasoning, it should be stated that in other cases the courts have sought to enforce this important provision of the policy as regards subsequent insurance, by declaring that the section of the mortgagee clause protecting the mortgagee against the acts of the owner, is qualified by the agreement relating to contribution. The decisions mentioned under this section make it clear that the insurer's interest is better protected by the full contribution clause; likewise, that the non-contribution clause is better designed to afford full protection to the mortgagee.

CHAPTER V

TYPES OF UNDERWRITERS

Classification of Insurers.—The fire and marine insurance business of the United States is transacted by four main types of insurers. Named in the order of their importance they are stock companies, mutual companies or associations, self-insurers, and Lloyd's organizations. Concerning mutual companies and associations a further classification may be made, viz., local assessment mutuals, deposit premium companies, ordinary premium mutuals, non-assessable mutuals, and ship owner's mutuals or "clubs." Lloyd's organizations may also be classified into Lloyd's of London and Lloyd's Associations.

Stock Companies.—By far the largest share of American fire and marine insurance is transacted by this type of company. As a rule, these companies operate over a widely extended territory, and of necessity require a large and intricate agency and home office organization. They insure all types of properties, along either the fire or marine line, as the case may be. A widely distributed business is desirable to make the loss ratio from year to year as uniform as possible, and for this reason most stock companies extend their efforts into any territory which offers a profitable business.

The distinguishing feature of stock companies is that they are owned and controlled by stockholders and are operated to yield profit to the owners. Liability is assumed by the company in its corporate capacity; a definite premium is charged and the consequences must be borne by the company alone, should losses exceed the

premium income. Owing to the hazardous nature of fire and marine insurance, it is only natural that there should have been an overwhelming tendency on the part of the insuring public to place reliance in corporate underwriting. Through the accumulation of large assets, stock companies can offer to the public a condition of financial strength far in excess of that which can be attained by individual underwriters. Just as is the case with banks and trust companies, the great stock in trade of stock insurance companies is a large surplus over and above all liabilities. The assets of the company must, of course, equal the unearned premium liability.¹ But over and above this item are the "capital stock" and the "surplus," the two together constituting a fund available to policyholders in case of extraordinary losses, and commonly called the "surplus to policyholders." The capital and surplus items will at times be made extraordinarily large by stock companies in order to inspire confidence in their unquestioned safety. Other things being equal, there is a natural disposition for the insured to select a company which is financially the strongest. Funds comprising capital stock and surplus are not idle, of course, but are invested in interest or divided bearing securities, and the income account of many of the companies thus shows a large investment return in addition to their underwriting profit.²

Competition has caused stock companies to exert every effort to improve their financial standing. Policyholders have the further advantage that such companies are regulated very strictly by the various states. They also have easy access to the annual financial statements which all companies must file for publication with the insurance

¹ See chapter on "The Reserve."

² For a general outline of the main headings of an insurance company's financial report, see page 221.

departments of the states in which they transact business, and are thus enabled to judge for themselves. It is also asserted that the self-interest of the stockholders, since their own investment is at stake, is a guarantee that the company will be wisely and successfully managed. Moreover, it is urged that a good stock company leaves nothing uncertain, the policyholders knowing exactly what their insurance will cost, since everything is guaranteed.

Local Assessment Mutuals.—Under this plan insurance is furnished on the payment of a cash premium, with the understanding that in case losses and expenses exceed the income the balance may be collected through assessments levied upon the members. The best examples of this type are the so-called “local mutuals”—“county,” “town,” or “farmers’ mutuals”—of which there are fully 2,000 in the United States, with total insurance in force of between five and six billion dollars. Companies of this kind are found in all except about six states. As reported by the United States Department of Agriculture, “in some states of the middle West fully three-fourths of all insurable farm property is now insured in the farmers own companies.”³

Assessment mutuals operate principally upon two plans. Some charge only a small cash premium intended to meet expenses and small losses and require policyholders to give their premium notes on which payment is demanded should losses and expenses exceed the cash premiums. Others follow a plan of not requiring premium notes, but of merely charging a cash premium and levying assessments if necessary. In both groups the liability of the members is usually fixed by the laws of the state or by the charter and by-laws of the company.

³ V. N. Valgren: “Organization and Management of a Farmers’ Mutual Fire Insurance Company,” United States Department of Agriculture. Bulletin, No. 530. Washington, 1917.

In most instances, local mutuals are organized by a group of farmers or by property owners in villages and small cities to secure the lowest possible rates. The business is begun by issuing policies to the original members. After the officers have been elected, and the organization perfected, the business is usually entrusted to the care of a secretary, who in many instances, if the company is small, may also pursue some other vocation, such as law, banking, or storekeeping. In this way the expense item is reduced to a minimum. The valuation of the property to be insured, and the desirability of the applications is usually left to the decision of the board of directors or an executive committee.

Both the merits and demerits of local mutuals are found in the fact that they operate in restricted districts. Because of their local nature they are able to eliminate much of the moral hazard so frequently found in fire insurance. If the company is small, most of the members are acquainted with each other. It is easier therefore to avoid overvaluation, and it becomes exceedingly difficult for a dishonest man to obtain insurance. Moreover, the insured usually does not bring the same loose moral code to bear on his actions when dealing with his neighbors and friends, as he does when dealing with an unknown corporation having headquarters in a distant locality.

But the writing of insurance in a restricted territory also constitutes an element of danger in that it loses sight of the inevitable law of average in insurance. So long as the fire loss record of the locality is sufficiently low or uniform, the mutuals may prosper, but upon the advent of several fires at about the same time they may break down. The number of mutuals that have gone insolvent is an exceedingly large one, and the cause in probably a majority of cases has been an unexpected series of large fires. The system of assessments provided

for such contingencies, while ideal in theory, will in practice often utterly fail because of the difficulty or impossibility of collecting the assessments. Moreover, companies of this type are not required, as a rule, to have any capital, surplus, or reserve fund. Many of these companies have been conspicuously successful, and are past the half-century mark of their existence, but this has been due mainly to their strict policy of insuring only a limited amount on comparatively non-hazardous risks, or to their luck in avoiding a rapid series of fires.

Many of the state laws relating to local mutuals recognize the necessity of protecting their members against just such a contingency. Thus in some states they cannot operate in large cities. The New York, Chicago, and Boston conflagrations made bankrupt nearly all the local mutuals operating in those cities, and showed the wisdom of such legislation. Other states limit their activity to the insuring of non-hazardous risks, such as dwellings, farm buildings, and stores when situated in a given district. Many states provide that their business must be confined to a single town or county, or at most to a limited number of counties, such as three or five. In most of the states, before their organization is complete they must produce evidence of having procured applications for a considerable amount of insurance, usually from \$50,000 to \$200,000, and that a certain portion of the premiums on this amount of insurance, usually 25 per cent, has been advanced in cash. Opinion, it may be added, is also crystallizing in favor of the creation of a reserve fund. "A reasonable reserve in the treasury of the company," as reported by the United States Department of Agriculture, "performs a very useful function by equalizing the assessment from year to year. In case unexpectedly heavy losses should be experienced it may thus prevent dissatisfaction on the part of the members. In an extreme case

it may even save the company from dissolution. The opinion appears to be growing among farmers' mutual insurance men that under a plan of annual assessments a reserve of about \$3,000 per million of insurance in force is useful as a shock absorber in the loss experience of the company."⁴

State Mutuals.—Many attempts have been made, usually with unsuccessful results, to apply the mutual assessment plan of fire insurance over one or more states. Such state mutuals, while retaining the objectionable features of the local mutuals—namely lack of assets, small volume of business, and assessments—also lack their elements of strength. The moral hazard is increased as the territory within which a mutual company does business increases. When such mutuals attempt to write insurance throughout an entire state they necessarily come into competition with the wealthier and more firmly established stock companies, and have difficulty in securing business except at inadequate premiums. They also, as a rule, lack the business organization and the trained staff of experts possessed by the stock companies, and to secure business in sections far removed from the home office must depend upon agents for the soliciting of insurance and the selection of risks. The result is that the service is not of the best, and the supervision over the selection of risks is often woefully inferior to that of the local companies. To insure their greater safety a number of states have passed laws with special reference to their organization and operation. The number of applications for insurance which must be in hand before their organization is perfected is usually much larger than is required of local

⁴V. N. Valgren: "Organization and Management of a Farmers' Mutual Fire Insurance Company," United States Department of Agriculture Bulletin, No. 530. Washington, 1917.

mutuals. The class of business which they may accept is carefully limited in certain states, while in others a limit is placed upon the amount of insurance which may be written on any one risk.

Deposit Premium Companies—Factory Mutuals.—The premiums charged by this type of company are redundant in character, i.e., estimated to be considerably in excess of what is needed to cover normal losses and expenses. At the end of stated periods so-called "dividends" are refunded to the policyholders. The cost of the insurance, therefore, equals the "difference between the deposit premium (plus loss of interest thereon) and the dividend." The right to levy assessments, however, exists in case of necessity, although that right, owing to the redundant premium, has been exercised very rarely.

Probably the most successful concerns coming under this heading are the so-called "factory mutuals," whose insurance in force aggregates approximately \$5,000,000,000, and whose conservative methods and careful management have attained for them an enviable reputation. The success of these organizations is chiefly attributable to their policy of preventing fire waste, rather than the mere payment of claims. When factory owners came to a realization of the importance of reducing the fire waste, they at first tried to coöperate with the stock companies in reducing the fire loss, and consequently the premium charge, but the companies in the main assumed the attitude at that time that they were insuring against fire losses, and were not in business to prevent them. Then occurred the Chicago and Boston conflagrations, which made necessary an increase of from 50 to 60 per cent in the rates charged by the stock companies. Factory owners, finding such charges too burdensome, sought relief through efforts at mutual coöperation. Low cost insurance was to be obtained through an organization which

would have for its main object the ascertainment and elimination of the causes of fire.

To this end the factory mutuels have made careful investigations into the different kinds of factory hazards, into methods of lighting and heating, and into the separation and isolation of dangerous processes. It was the factory mutuels that were most active in bringing about the introduction of automatic sprinkler systems, which, as will be explained later, have so radically revolutionized the methods of fire protection. These companies also set an extremely high standard for construction and fire-extinguishing appliances, and subject all of the insured properties to very careful periodic inspections. Strict conformity with all of their requirements is necessary on the part of the policyholder in order to secure and retain membership.

Efforts of factory mutuels along the lines suggested have reduced the fire waste in factories from proportions that were appalling to very small figures (from about \$2.00 per \$100 of value to about 7 cents), and have brought about changes that the stock companies have been compelled in self-defense to adopt. Premiums are charged according to the nature of the hazard involved. The right to assess members, however, is reserved, and the assessment liability is usually limited to an amount equal to from three to five times the cash premium. But, as already stated, very few of these mutuels have ever found it necessary to collect an assessment. Instead, the cash premiums have almost invariably covered all losses and expenses. Some of the concerns refund annually from 60 to 90 per cent of their cash premiums, and at the same time possess surplus funds equal to or considerably in excess of the entire redundant premium. Moreover, to guard against the conflagration hazard, these concerns have organized into reinsurance groups for the purpose

of apportioning the risks of each among all the others so as to obtain the widest possible spread of business.

Ordinary Premium Mutuals.—The cash premium in these cases is based either on the full stock company rates or a percentage thereof. The thought is to have the premium sufficient to meet losses and expenses, but not to charge much in excess of that requirement. Should premiums prove insufficient, policyholders are liable to assessments for the deficit. On the contrary, should premiums be more than ample, some of the companies make a refund to the policyholder, whereas others accumulate the savings in a surplus fund. In many instances, stock company methods are pursued in the acquisition of business through agents and the payment of commissions.

“Reciprocal” or “Interinsurer” Associations.—Such organizations are mutual in the sense that each policyholder in the arrangement is insured by all the others, and in turn also insures them to a stipulated extent. The members are represented by an attorney-in-fact upon whom they have all individually conferred full power to manage the affairs of the organization, subject only to such restrictions as may be contained within the terms of the powers of attorney or of the organization. Each member's liability is definitely fixed. The names of all the members are usually published for each association in the annual insurance department reports of the several states, the amount of the “liability assumed” by each member being printed immediately after the name. If there are 100 members in the group, and each is responsible for \$2,000, it follows that \$198,000 is available for a loss, assuming that each of the 99 members is able to pay the amount assumed as an insurer. Sometimes all members assume the same liability, but at other times the amount varies. Thus in one association, comprising

91 leading mercantile firms as members, one assumes a liability of \$40,000, 43 of \$20,000 each, 21 of \$10,000 each, and 26 of \$5,000 each.

“Reciprocals” have been the subject of much discussion in recent years. In their favor it is argued (1) that their cost of operation is practically limited to the attorney’s remuneration, which may be properly controlled; (2) that any saving in the premium is refunded to the policyholder; (3) that the volume of business is assured through the self-interest of the members themselves, and that the large cost of acquiring new business to which other companies are subject is thus obviated; and (4) that assessments may be limited, and liability for a possible conflagration loss may be reduced, through reinsurance with other concerns. Those opposing this type of organization point to the numerous instances where the above features have not been observed. They direct attention chiefly to the large measure of control often possessed by the attorney-in-fact, to the large profits that have been made by such attorneys, and to the indefinite cost of any insurance which involves an assessment liability.

Non-assessable Mutuals.—A limited number of companies are mutual in their organization but issue policies on a non-assessable basis. While sharing in refunds in case of success, policyholders cannot be asked to pay anything in addition to their cash premiums in case of failure. These companies usually follow the business methods of the stock companies, and generally seek to protect their policyholders through the accumulation of a large surplus. It may be added that the only mutual company transacting a general marine insurance business belongs to this type, and after a long successful career stands in the very forefront of the business.

Ship Owners’ Mutual Associations or Clubs.—With the single exception of these mutuals and the one company

referred to above, marine insurance is limited to the stock company and Lloyd's plans. Aside from the usual marine hazards, vessel owners are liable for property and personal damages to third parties. The coverage relating to this type of risk is commonly called "protection and indemnity insurance," and in most instances is placed by vessel owners in so-called protection and indemnity clubs. While common in England, only one such club—the American Steamship Owners' Mutual Protection and Indemnity Association⁵—has been organized in the United States.

⁵ This Association had enrolled recently a tonnage of about eight million tons, this tonnage including that of the United States Shipping Board. The risks covered by this Association include the following:

"Owners' liability, in respect to the vessel insured, for—

1. Injury to any person, including laborers handling cargo, members of crew, passengers, persons on another vessel, or to any other person, including burial expenses, not exceeding \$100.
2. Damage to other vessels by collision, to the extent of one-fourth of the amount, when this risk is not covered in hull policies.
3. Damage to other vessels and their cargoes otherwise than by collision, including damage by wash of steamer, crowding other vessels ashore, causing two or more other vessels to collide, etc.
4. Damage to docks, piers, jetties, breakwaters, buoys, cables, and other fixed or movable objects, and to property on docks or piers.
5. Damage to cargo, or responsibility for cargo carried or to be carried, including shortages and overcarriages, exclusive of shortage consequent on B/L guarantee. Subject to a stated deduction on each voyage.
6. Expenses of removing the wreck of the vessel.
7. Repatriating members of the crew.
8. Extraordinary quarantine expenses, by reason of outbreak of plague or other contagious disease on the vessel. Subject to deduction of \$200.
9. Illness of passengers or seamen, including burial expenses up to \$100.
10. Smuggling, mutiny, or unfounded claims of crew.
11. Customs and immigration fines and other fines arising from neglect or default of captain or crew.
12. Cargo's proportion of general average, if not otherwise recoverable, as in cases where the G/A is brought about by the vessel's negligence.
13. Legal and other expenses incurred in relation to any of the above risks, or when authorized in the interest of the association."

Such clubs are essentially assessment societies, since at the end of a stipulated period, usually a year, the total loss paid is ascertained, and a levy is assessed over the various members in proportion to the tonnage each may have entered in the association. A low expense cost is the chief advantage, especially since the organization is not operated for profit-making purposes. But against this gain is the element of uncertainty, the assessment levy varying from year to year, according to the fluctuating record of losses. It is for this reason that many owners prefer to insure with companies or with Lloyd's at a definite premium, and thus know in advance the exact extent of their liability. Again, where vessels are new or of high class, owners may be reluctant to join such associations, preferring to insure where the underwriter recognizes the merits of the vessel. In other words, they are opposed to having the identity of their vessel lost through a merger with numerous other vessels, many of them inferior, and at the end of the year be assessed in proportion to tonnage, irrespective of the quality of the property.

Lloyd's of London.—Turning next to a discussion of insurance by individuals, Lloyd's of London deserves our chief consideration, since it constitutes the greatest body of individual underwriters in the world.⁶ Its membership in 1920 consisted of 1,096 underwriting members, 92 non-underwriting members, 404 subscribers, 84 associates, and 1,600 substitutes. About 1,400 agents and sub-agents represented the organization in practically all countries of the world, and those located at the most important places are empowered to settle and pay claims.

⁶ According to the Act of Incorporation, Lloyd's exist for the threefold purpose of conducting an insurance business, of protecting the commercial and maritime interests of its members, and of collecting and disseminating information pertaining to shipping.

For 1920 the premium income was approximately 30 millions sterling, of which 18 millions was for marine and 12 millions for other types of insurance. Lloyd's may thus be regarded as the largest single insurance institution in the world, writing marine, fire, and many other kinds of insurance, originating in practically every country of the world.

In many respects Lloyd's resembles our stock exchanges. It assumes no responsibility whatever for the solvency of its members. It seeks only to provide proper facilities to its members for the convenient conduct of their business and to limit admission to men of recognized honesty and financial standing. As a guarantee for the fulfillment of contracts, however, Lloyd's, as an organization, insists upon the following with respect to each of its members:⁷

(1) The unlimited personal liability of each underwriter.

(2) A minimum deposit of £5,000, proportionately increased if the underwriter's annual account exceeds £10,000. These deposits amounted to over £7,000,000 in 1920.

(3) A trust deed signed by the underwriter, providing that all his premiums and other underwriting moneys, as well as the investments of the same, shall be placed in trust for the payment of his underwriting liabilities and expenses, and so as to be exclusively applicable to that purpose.

(4) An annual guarantee policy, as laid down by the Board of Trade, must be furnished by the candidate for the amount of his non-marine premiums for the year, or an equal amount in cash.

⁷ The author is indebted for the following enumeration to a lecture on "The Story of Lloyd's," delivered by the Chairman of Lloyd's before the Insurance Institute of London, November 21, 1921.

(5) A compulsory annual audit of each underwriter's account to prove his ability to meet his financial obligations. These audit regulations have been approved by the Board of Trade.

Other important features of Lloyd's, indicative of the nature of its business and the methods pursued in connection therewith, are the following:

(1) If conforming to the above requirements for solvency, the members are free to do as much underwriting as they like and may pursue any kind of insurance they choose. Accordingly, a great variety of risks is assumed. A very considerable part of the business written by Lloyd's members in the United States consists of risks so hazardous or so unusual in nature that no other insurer can be found.

(2) The risks are placed by brokers who pass before the desks of the various underwriters and present a so-called "slip," which is the proposal of insurance. Each accepting underwriter signs his initials, and indicates thereafter the amount of liability he is ready to assume.

(3) The underwriters are careful to spread their risks widely and, therefore, the amount assumed by each is usually not large, i.e., bears a proper relation to the underwriter's resources.

(4) When the policy is finally issued, it will bear the signature of each of the underwriters who initialed the original slip, and after each signature will be recorded the amount of his personal liability. For all practical purposes, however, the insurance is closed, and the voyage may be begun, as soon as the slip has been initialed for the requisite amount of insurance. The actual issuance of the policy is only a formal detail.

(5) In their operations Lloyd's members are not limited to their own financial resources. Outsiders may participate indirectly by offering their capital to an underwrit-

ing member and sharing in the profits of the business. In this way a very much larger share of the nation's capital contributes to the work of Lloyd's than would be the case if transactions had to be limited to the aggregate personal resources of the members.

(6) To economize in time, especially where insurance is placed in distant markets, various groups of underwriters now organize themselves into syndicates and fully authorize some syndicate manager or agent to act for them as a collective group. This manager or agent is empowered to accept a stipulated volume of insurance on any given risk, which is then apportioned among the members of the group according to the terms of the syndicate agreement. To illustrate, the writer has before him a policy calling for a total of £7,650 insurance. This amount was assumed by 249 individuals, organized into 24 syndicates. Each group is represented in the policy by a stamped endorsement (the 24 endorsements being scattered over the vacant portions of the policy), containing the names of the members, the proportion assumed by each member, and the signature of the agent or manager. It may be added that the largest amount assumed by any group was £1,600 and the smallest assumption £10, while each of twelve groups underwrote only £125 or less. The following two examples, selected from the aforementioned 24 instances, will illustrate the nature of these endorsements:

£ 600

E. W. Richardson	two ninths	
A. J. Richardson	one ninth	
B. H. Foulger	one ninth	
H. Munt	one ninth	of six hdd. pds.
W. J. H. Brodrick	one ninth	Per signature of
J. M. Cazenove	one ninth	agent
Home Gordon	one ninth	
A. J. L. Circuit	one ninth	

£ 500

A. L. Stuge.....	5/30ths	
W. H. Lazenby.....	1/10th	
R. F. A. Riesco.....	1/10th	
Kenneth Bibby.....	1/10th	
Harry Holmes.....	1/15th	Five hdd. pds.
E. B. Richardson.....	1/15th	Per signature of
T. L. Devitt.....	1/15th	agent
Reginald Holmes.....	1/15th	
C. N. Brown.....	1/15th	
E. P. Sturge.....	1/15th	
Francis Wimbush.....	1/15th	
H. J. Letts.....	1/15th	

American Lloyd's Associations.—Aside from the business conducted by Lloyd's of London there is very little individual underwriting in the United States. In fact, the practice is limited in a modified form to a comparatively small number of American Lloyd's associations, and even these are declining in number and importance. While named after their more illustrious prototype, their organization is radically different. They may be defined as voluntary partnerships in which each member usually agrees to hold himself individually liable for the payment of losses on a given line of insurance up to a specified amount only, although in some instances the individual liability is "unlimited." In most cases, therefore, the value of the insurance depends upon the financial strength of the individual members in the partnership, though in some instances greater security is offered in the form of a guarantee fund which is available for the payment of losses. These organizations also fail to give to the insuring public the benefit resulting from the strict disciplinary code and the financial guarantees imposed upon its members by Lloyd's of London. It should be added that the policy is issued for all the members constituting the association by their joint attorney.

Self-insurance.—To complete our list, reference should be made to the practice of self-insurance by certain owners, principally large corporations. Self-insurance means that there is no transfer of the risk to an outside independent underwriter. In one sense the owner may be considered as “running his own risk,” yet it would be more accurate to regard any real plan of self-insurance as based upon scientific considerations rather than upon haphazard guesswork. Safe use of the plan is limited to the following conditions:

(1) The number of units of property owned must be so numerous and so evenly distributed in value as to make the law of average applicable. Even where the advantage of numerous risks presents itself, careful owners usually self-insure only the less valuable items and use outside insurance for those units that are so costly as to make a single loss sufficient materially to exhaust the self-insurance fund, or otherwise cripple the financial standing of the owner.

(2) Where the units are sufficiently numerous but nevertheless very valuable, self-insurance may be limited to the assumption of only part of the value of each unit, the balance being insured with outside insurers.

(3) The owner's self-insurance fund should be created gradually, and there should be an avoidance of a sudden transfer from outside insurance to self-insurance. The method pursued should consist of a gradual decrease in the liability insured in outside agencies and a corresponding increase in the self-assumed liability. To make a sudden transfer from 100 per cent outside insurance to 100 per cent self-insurance is very unscientific in that a loss of large proportions in the early stages will much more than wipe out the self-insurance fund. It takes time to build up such a fund, and successful accumulation is dependent chiefly upon good fortune in not meeting

with a staggering loss in the early stages. Even where a fund has been gradually built up to an adequate total, it is the policy of some corporations to continue adding thereto. The fund is regarded as an invested asset, to be used for the payment of extraordinary losses, should they occur, or for some other purpose like the maintenance of dividends during periods of business adversity.

CHAPTER VI

AGENCY AND BROKERAGE

Importance of Agency in Fire Insurance.—American fire insurance companies found it necessary, owing to the vastness of the territory which most of them seek to cover, to develop a comprehensive and well-organized agency system. It is through agents that the companies reach the insuring public and secure the business upon which they exist. By far the largest share of fire insurance in the United States is written by many thousands of local agents stationed in the numerous cities and towns of the country. (Each of these local agents represents one or more companies in his particular locality, and is authorized to countersign and issue policies, and to collect premiums.)

(The company usually gives its agents written instructions as to their authority.) The authority thus conferred is very broad, although restrictions are generally imposed with reference to such matters as prohibited risks, line limits, etc. To a large extent the company must depend upon the local agent's judgment concerning the moral hazard and the selection of risks, and upon his knowledge of local conditions. The company is also dependent for its share of business in the particular community upon his personal work and his ability to compete as a solicitor. The local agent must obtain and hold the business. To this end he should possess a good understanding of the policy and the numerous endorsements commonly used,

so that his client may be given the fullest possible protection. He should also be able to inspect properties with a view to making recommendations for corrections or improvements which will lower rates to the utmost.

Although serving as the legal representative of the company, the local agent is essentially a middle man between the company and the insured. He represents both the company and the insured and should therefore serve both. In the interest of the company he should comply with all instructions, and be prompt in the remission of premiums and the reporting of all material information relating to insurance written and fire losses incurred. With respect to the insured, his constant aim should be not merely to write *a* policy but *the* policy, i.e., the contract best fitted to the needs of his client. His commission, although paid to him directly by the company, is really paid by the insured and should ever be regarded as compensation for real service, and not merely for the placing of a policy. This means that he should not only arrange the best possible protection, but should strive to reduce the cost of the insurance to the utmost through advice in relation to any possible improvement in the risk, despite the fact that his commission depends upon the size of the premium.

Method of Reporting Business Written.—In view of the many agents employed, and the many important matters which must be entrusted to their care, it is essential that the companies have a systematic way of checking up their work. To facilitate the writing of insurance, local agents are supplied with blanks, signed policy forms, books of record, printed clauses and other necessary equipment. Among these blank forms is the so-called “daily report” that has proved highly important in perfecting the organization of the agency system. (For copy see page 83.) This report is filled out daily by the local agent and is

COPY OF DAILY REPORT

No. Commission
No. of Previous Policy %

THE...X...INSURANCE COMPANY, NEW YORK

MAP: Sheet No.	Other Insurance in This Company on or in Premises	{	Insurance in other Companies
Block No.			
Street No.	Class No. Bp. Bu. Fp. Fu. Su. Sp.		
MR.	FR.	SURVEY NO.	

Amount, \$..... Rate..... Premium, \$.....

In Consideration of the Stipulations herein named

and of.....Premium,

Assured:.....

Term:.....

from.....day of.....19..., at noon,

to.....day of.....19..., at noon,

Against Loss or Damage by FIRE.

Amount.....Dollars

EXACT COPY OF FORM ON POLICY

Agents will please answer the following, to facilitate checking rate:

DWELLINGS

What kind of roof?.....
Are chimneys brick and built from
ground or living room?.....
Do smoke pipes enter chimneys unob-
structed from view?.....
Is dwelling occupied by more than three
families?.....
Is dwelling exposed by dwellings or pri-
vate barns only?.....
Is dwelling in a continuous row of more
than three, or if frame is there a space
of less than three feet between each?
Is ground area 2500 square feet or over?

PRIVATE BARNs

What kind of roof?.....
Chimneys (same information as for
dwellings; see above).....
Is barn exposed by dwellings and private
barns only?.....
Is barn in a continuous row of more than
three?.....
Does horse capacity exceed four?.....
.....
.....
.....

This Report Mailed.....19.. ..Agent.

mailed to the home office or the department of the district in which he is located. It contains an abstract of the policy written by the agent during the day, including in full all the written-in or descriptive portions of the policy. By this means the general agent or department head is enabled to keep in close touch with the work done by the local agents, and can much more readily rectify errors than would be the case under reports rendered at longer intervals.

When the daily reports of the local agents arrive at the company's office (in some cases they are first sent to the "stamping department" of some underwriters' association for approval), they are taken in hand by special examiners and are carefully reviewed with a view to discovering errors in the wording of the contract or defects in the risk which may make it desirable to charge a higher premium or to reject the insurance entirely. If such errors or defects are found, the agent is instructed to cancel the policy or have it changed to meet the wishes of the company. A monthly account of all the premiums received is also sent by the local agent to the home office or the department of his district. This monthly statement gives a summary of (1) all the policies written during the month by number, amount insured, gross premium, term of contract, and date of expiration; and (2) all policies canceled during the month, stating in connection with each the number, amount of insurance, and the return premium.

Statutory Regulation of Agents.—In most states the legal status of insurance agents is defined by statute. The term "agent" is usually declared to include any "person not a duly licensed insurance broker, who, for compensation, solicits insurance on behalf of any insurance company, or transmits for a person other than himself an application for a policy of insurance to or from such

company, or offers or assumes to act in the negotiation of such insurance." (The tendency of state legislation is to make all agents general agents of the company) except under certain stipulated conditions, and only a few states provide that one dealing with a soliciting fire insurance agent is bound to ascertain the extent of his authority.

The various states not merely attempt to make soliciting agents specifically the agents of the company, but carefully supervise the operations of the agency force representing companies incorporated in other states. The law of Pennsylvania, in this respect, is probably as nearly typical as that of any other state, and will serve as an example. No person, according to the Pennsylvania law, shall, under heavy penalty, act as agent of a foreign (company of another state) or alien company until such company has complied with all of the state's insurance laws. All foreign companies must certify to the Insurance Commissioner from time to time the names of all their agents, and no agent may transact business for such company until he has received a certificate from the commissioner stating that the company has complied with the law, and that the person named has been appointed its agent. Furthermore, heavy penalties are imposed for various kinds of misconduct. Briefly summarized, the laws referred to in this connection are directed against the following acts of an agent:

- γ (1) Rebating any portion of the premium or of the commission thereon, or giving any other valuable consideration either directly or indirectly as an inducement to insurance.
- / (2) Fraudulent conversion or wrongful use of premiums collected.
- : (3) Representing or advertising himself as the agent of an unauthorized or fictitious company.
- / (4) Issuing any false or misleading estimates or incomplete comparisons.

Powers and Liabilities of the Agent.—*Agent's apparent powers coextensive with those of his principal.*—The general rule, relating to the powers of agents is stated by Elliott as follows: "An agent may bind his principal when acting within the scope of his authority, and his power will be determined not alone by the actual but also by the apparent or ostensible authority." When dealing with an agent, the insured may assume that he is authorized to exercise all powers coming within the scope of his apparent authority. It is only when by circumstances or documents the insured becomes doubtful of the status of the agent that he is bound to inquire into the facts. In the absence of policy restrictions upon the agent's authority to waive forfeitures—and even under such circumstances we shall note much disagreement in the court decisions—the acts and knowledge of the agent in relation to anything pertaining to the policy are generally held by the courts to be the acts and knowledge of the company, thus stopping it from taking advantage of any forfeiture occasioned by the agent's errors or fraudulent acts.

Liability of company for the acts of sub-agents and employees of the agent.—Although there is no unanimity in the decisions, the weight of authority is to the effect that the company is liable not only for the acts of its agents but also for the acts and knowledge of sub-agents and others employed by the agent. In insurance it is common practice, and is frequently found necessary, for agents to employ others to assist them in their work. Having delegated their authority to them, the courts have regarded it as "just and reasonable that insurance companies should be held responsible not only for acts of their agents, but also for the acts of the agents employed within the scope of their agents' authority." While it may be argued that the company has not authorized its agents to delegate their authority to others, and that it

would therefore be an unreasonable extension of the company's liability, it must be remembered that agents are employed by the companies in accordance with the usages and necessities of the business. While the company may not expressly have authorized its agents to delegate their authority, it did know or should have known that, according to the general usage or necessity of the business, these agents would be obliged to employ others to assist them in their work.

Legal effect of agents' opinions on the meaning of policy provisions.—In the course of their daily business agents are frequently asked to express opinions on the meaning of policy provisions, and it is of the utmost importance that definite relations should exist between the company and its agents as regards the expression of such opinions. What, then, is the legal effect of the agent's opinion? The general rule is that no legal effect can be given to such opinions in case, for example, they result in misleading the insured as to the meaning of any policy provision. This view is based on the theory that an agent's opinion as to the meaning of any section of the contract does not create new or change old obligations.

Personal liability of the agent for misconduct to his principal.—The relation of the agent to his employer is such that he must never further his own personal interests by disobeying or exceeding his instructions. Any misconduct of the agent makes him personally liable to his principal for the damage done. Among the many legal textbooks announcing this principle we may quote from Story on Agency: "Whenever an agent violates his duties or obligations to his principal, whether it be by exceeding his authority or by mere negligence or omission in the proper functions of his agency or in any other manner, and any loss or damage thereby falls on the principal, he is responsible therefor, and bound to

make full indemnity." Thus suppose the agent issues a policy in excess of the line he was instructed not to exceed, and that a total loss occurs before the company has found it possible to accept or decline the insurance. By issuing the policy the agent bound the company and it is obliged to pay the loss. The agent, however, is legally liable to the company for the amount of loss paid in excess of the line limit that he was instructed not to exceed. If ordered by the company to cancel a policy, neglect to obey the order renders the agent liable for the amount of the loss. Similarly, the agent is personally liable for any damage resulting to the company because he may, contrary to instructions, waive any policy provision.

An agent may not act as such for two parties in the same transaction.—Such a dual relationship is generally regarded illegal when the agent exercises discretion for either party. Thus where an agent issued the policy of one of his companies as reinsurance of another company of which he also was agent, and without the consent of both companies, the court held that he assumed "an antagonistic position, and there would be a conflict of interests. Contracts thus negotiated are void at the option of any non-assenting party thereto. It matters not that the agent has acted fairly and honestly, and that neither party to the contract has suffered injury."

Waiver Provision in the Standard Fire Policy.—Lines 78 to 88 of the New York standard policy provide that "no one shall have power to waive any provision or condition of this policy except such as by the terms of this policy may be the subject of agreement added hereto, nor shall any such provision or condition be held to be waived unless such waiver shall be in writing added hereto, nor shall any provision or condition of this policy or any forfeiture be held to be waived by any requirement, act or proceeding on the part of this Company

relating to appraisal or to any examination herein provided for; nor shall any privilege or permission affecting the insurance hereunder exist or be claimed by the insured unless granted herein or by rider added hereto." From the standpoint of agency, this important clause contains two main thoughts, namely, (1) *no one* may waive any portion of the policy which is not by the terms of the contract the subject of special agreement added thereto, and (2) even with respect to such provisions every waiver must be *in writing endorsed on the policy*. The clause would seem to have for its main purpose the elimination of all oral waivers.

The reasonableness of stipulations like the above must be conceded when one takes into account the fact that most large companies are represented by hundreds and sometimes thousands of agents and that in the desire to obtain business many are often tempted to make promises not permitted by the policy, or to overlook or conceal representations or information which, had the same been known to the company, would have caused it to refuse the policy. It, therefore, seems reasonable that the companies should seek to protect themselves against such contingencies by stating expressly in the contract itself that "no one has the power" to waive any policy conditions, except in certain cases clearly defined by the contract, and then only in writing endorsed on the policy. It may be added that similar reservations are found in life, marine, and most other kinds of insurance policies.

Despite the apparent reasonableness of such policy provisions, however, the various court decisions are by no means in harmony as to the legal force of the same.¹ Most

¹ For a detailed discussion of the legal effect of such provisions, see George Richards' "A Treatise on the Law of Insurance." Mr. Robert P. Barbour summarizes the situation with the statement that "although the policy contains a provision that no agent shall have

of the decisions deal with the subject of oral waiver in its relation to fire policies. Here most of the state courts have refused to uphold such policy provisions, and have taken the position that where facts constituting a forfeiture are known to the agent at the time of the issue of the policy the company may not consider the policy forfeited. Various reasons have been offered by the courts for taking this view. One court regards the doctrine "as peculiar to the law of insurance and as founded on the laudable design of preventing the perpetration of a fraud through obtaining a premium by the issuance of a policy known to be void *ab initio*." Other courts refuse to uphold the provision "in the interest of fair dealing," or on the ground that "if the principal has inherent, inalienable power to waive either orally or in writing so has the agent."

But it should be noted that the Federal courts have departed from the rulings so generally accepted by the state courts. In the famous Northern Assurance Company case (183 U. S., 308), characterized by Mr. Richards as a "decision of perhaps greater practical moment than any other rendered in the law of insurance within half a century," the United States Supreme Court refused to uphold the doctrine of oral waiver with respect to fire insurance policies and repudiated it as fundamentally unsound. The plaintiff in the case had received from the defendant a \$2,500 standard fire policy on household effects. The policy provided that it would be avoided by other insurance without written consent, that all waivers were to be in the form of written agreements, and that agents were with-

power to waive any provision or condition thereof, nor grant any privilege or permission affecting the insurance, unless written upon or attached to the policy, the courts have almost uniformly held that an oral agreement between insured and agent may waive any provision or condition of the policy, and, similarly, may give permission for something that would otherwise void the policy."

out authority to waive any policy provision otherwise. When receiving the policy, the plaintiff failed to acquaint the company with the fact that he already had \$1,500 of insurance on the same property. He maintained, however, although his statement was flatly denied by the agent, that the existence of the other insurance had been mentioned to the agent at the time and that said agent, without raising any objection, signed and delivered the policy which made no reference in writing to the other insurance. In reversing the decision of the circuit court of appeals, which found for the plaintiff, the United States Supreme Court said:

“The plaintiff’s case, at its best, is based on the alleged fact that the agent had been informed, at the time he delivered the policy and received the premium that there was other insurance. The only way to avoid the defense and escape from the operation of the condition, is to hold that it is not competent for fire insurance companies to protect themselves by conditions of the kind contained in this policy. So to hold would, as we have seen, entirely subvert well-settled principles declared in the leading English and American cases, and particularly in those of this court. This case is an illustration of the confusion and uncertainty which would be occasioned by permitting the introduction of parol evidence to modify written contracts, and by approving the conduct of agents and persons applying for insurance in disregarding the express limitations put upon the agents by the principal to be affected. It should not escape observation that preserving written contracts from change or alteration by verbal testimony of what took place prior to and at the time the parties put their agreements into that form, is for the benefit of both parties.”

Brokers Distinguished from Agents.—*Definition and licensing of brokers.*—The statute law of most states makes

a distinction between insurance brokers and insurance agents. A broker is defined in most instances as any person "who, for compensation, not being the appointed agent or officer of the company in which such insurance or reinsurance is effected, acts or aids in any manner in negotiating contracts of insurance or reinsurance for a person other than himself." Most of the laws provide that no person shall act as an insurance broker until he has procured from the Insurance Commissioner a certificate of authority so to act. Such certificate of authority authorizes the broker named therein to negotiate and place contracts of insurance with any company established in the state, and with the agents of any foreign company duly authorized to transact business within the state. In a considerable number of states, including New York and Pennsylvania, laws have also been enacted governing the brokerage of excess lines of insurance. Under such laws the Insurance Commissioner may issue a license permitting the licensee to act as a broker in procuring policies of fire insurance from corporations or associations which are not authorized to transact business in the state, provided both the insured and licensee execute affidavits, to be filed with the insurance department, that sufficient insurance cannot be obtained in companies legally authorized to transact business in the state.

Services of the broker.—Since the broker is not restricted to any given territory or to any particular company or companies, he is often called the free-lance of the business. Some brokers limit their activity almost entirely to a single locality, but others seek the business of large concerns whose properties may be numerous and widely distributed. To such clients, especially, the broker performs a very useful service. In fact, he should fulfill the functions of an expert, capable of giving his client the best service with respect to rates, forms and clauses, selec-

tion of underwriters with due regard to their financial strength and business reputation, and promptness in binding large amounts of insurance. In general, he should free his client from responsibility in the negotiation of insurance best fitted to meet the needs of the business under consideration. Where the properties of his client are scattered over a territory so large as to present different company practices in one locality from those in another, the broker may render the added service of coordinating all the insurance on a uniform basis. Such a result, it is clear, can be accomplished much more readily through one single broker, than by negotiations with many agents located in various places and representing different companies. Very frequently the broker deals directly with the home or branch office of the companies, although the policies are issued by the local agent.

In marine insurance a considerable portion of the business is negotiated between insured and insurer through personal interview or letter. By far the largest share of the business, however, and the proportion is increasing, is placed indirectly through brokers representing the merchant or vessel owner. Unlike the practice in other leading lines of insurance, the "agent"—legally the agent of the insurer—is comparatively rare in marine insurance. The highly technical character of the business, owing chiefly to the lack of uniformity in policies, forms and practices, the highly competitive character of the business, and the enormous size of the risks to be placed, often involving amounts of insurance so large as to require the selection of from 25 to 50 and even more companies, makes the use of brokers indispensable to the great majority of merchants and vessel owners. Besides negotiating the insurance, marine insurance brokers also represent their clients in the adjustment and payment of claims. Here the broker can be very serviceable in preparing the docu-

ments of proof, in examining his client's statement of loss, and in making certain that the settlement offered by the underwriter is such as gives the insured the full amount he is entitled to under the terms of the contract. Where doubt exists as to the liability of the underwriter for certain losses, the broker should also take charge of the formulation of the facts and present his client's case.

Legal status of the broker.—There has always been considerable disagreement in the various states in regard to the legal position which the insurance broker bears to the insured. In some states the courts have declared the broker to be the agent of the party who pays him for his services, regardless of the source of employment. This rule, however, will always involve uncertainty until the courts fix the ownership of the fund from which the broker is compensated. According to other states the broker is held to represent the insurance company as its agent as regards the delivery of the policy and the payment of the premium, but is the agent of the insured in all other matters pertaining to the insurance. Some states have also seen fit, no doubt for the benefit of the insured, to enact special statutes making the broker the agent of the insurance company in certain matters. In the majority of states, however, the broker is regarded as the agent of the insured in all matters, and is declared by statute to represent the insured and not the company.

The importance of this rule to the insured should be emphasized. When transacting business with a broker in these states it is well for the insured to bear in mind that the broker is his agent, and that consequently the act or knowledge of the broker is his act or knowledge. Many important illustrations of this principle may be found in the decisions of our state supreme courts. In *Sellers vs. Commercial Fire Insurance Co.* (Alabama, 16 Southern Rep., 798) the court held, "that the broker was the agent of

the insured and not of the company, and that any misrepresentations in the application, due to an error of the broker, which were made warranties, avoided the policy." Another representative case, illustrating the importance of the distinction between insurance agents and brokers, is that of *The Pottsville Mutual Fire Insurance Co. vs. Minnequa Springs Implement Co.* (100 Pa. St., 137). According to the facts of this case, the policy required the payment of the actual cash premium to the company before becoming effective. "A," the property owner, applied to "B," a broker, for insurance, and "B" arranged to procure the policy through "C," another broker. "C," in turn, found it convenient to apply to broker "D" for the insurance, and "D" obtained the policy from an authorized agent of the company. The policy when received by "D" was delivered to "A" through the hands respectively of "C" and "B," who, it will be remembered were brokers. When "A" received the policy, he paid the premium to "B," who, in turn, paid it to "C." During the interval that "C" held the premium, and before passing it on, the property was destroyed. The company refused to pay the claim on the ground that there had been no payment of the premium, since "C," a broker, was the agent for all purposes of the insured and not of the company. The court held that since "B," "C," and "D" were all brokers and the agents of "A," payment of the premium to any of these parties was not payment to the company, and a loss having occurred the company could not be held liable.

It should be stated, however, that some courts have held differently in cases like the above example, where it can be shown that arrangements have been made whereby the broker makes a periodical settlement with the company for premiums collected. In the case of *Riley vs. Commonwealth Mutual Fire Insurance Co.* (110 Pa. St., 144), "A"

requested a broker "X" to procure for him a fire policy, and "X" obtained the same from "C," who was the agent of the company. "X" received the premium from "A," but retained it, expecting to keep the same until the end of the month when the usual monthly settlement between himself and the company was to be made. While thus retaining the premium a loss occurred, whereupon "X" tendered the premium to "C," who refused to take it. Although the policy contained a provision, just as in the previous case, that there should be no binding contract until the actual cash premium had been paid to the company, the court held that, owing to the relation of debtor and creditor which existed between the broker and the agent of the company, the policy was valid and the agent obliged to accept the premium.

CHAPTER VII

DESCRIPTION OF THE PROPERTY INSURED

Two sections of the standard fire policy refer to the description of the property that is covered by the contract. The first of these refers to the description of the nature and location of the property; and the second relates to the effect upon the validity of the policy of concealment or misrepresentation in any matter pertaining to the insurance. In some policies there is another provision to the effect that any application, plan, or description of the property shall be a warranty and shall constitute a part of the contract.

Description of Character and Location of Risk.—With reference to the description of the character and location of the risk, the standard policy provides that the company insures “to an amount not exceeding \$, to the following described property while located and contained as described herein, or pro rata for five days at each proper place to which any of the property shall necessarily be removed for preservation from fire, but not elsewhere, to wit”; and then follows a blank space of considerable size in which may be written the description of the property insured. Nothing could seem more definite than the above statement, and one would anticipate but little controversy as to its proper meaning. The importance in fire insurance of the location of the property is well recognized, and it is a well-established doctrine that an insurance policy covering property in a certain specified place will not follow the property on its

removal to a different location. Yet some courts have qualified this general doctrine, and, while admitting that the location of the property is an essential factor, hold that the policy contract must always be viewed with reference to the character of the property, a primary consideration involved in the negotiation for the insurance, and the reasonable use to which the property must necessarily be put. Thus where a policy insures a stock of goods as contained in a specified place and "nowhere else to wit," the policy will be held to cover this property only while located in the described building, and the insurance will not follow the property if removed to another locality. If, on the contrary, however, the property is of such a character that it must necessarily be moved from place to place, the presumption is made in some states that the exact location of the property is a matter of subordinate importance which must be viewed in the light of existing circumstances.

As an instance, where the section of the policy concerning the location of the property was interpreted leniently with reference to the character of the property, we might mention the case of *McClure vs. Girard Fire and Marine Insurance Company*, 43 Iowa, 349. The property destroyed was a vehicle which was insured along with other property described in the policy as contained in a certain building and "nowhere else to wit." The vehicle in question, however, had been removed to a carriage shop for repairs, and while in this new location was destroyed by fire. The company denied the claim on the ground that the property had been moved, and that its removal had increased the risk because the danger of fire to property while contained in the repair shop was greater than in the building specified in the policy. The court, however, viewed the policy with reference to the character of the property and rendered a decision favorable to the in-

sured in the following words: "It may be conceded that the situation of the property is mentioned in the policy as a fact affecting the risk. The words describing the situation must be regarded as a warranty, not only that the property was contained in the building but would continue so, and if at the time of the loss the carriage was not contained in the building within the meaning of the policy we do not see how the plaintiff can recover. . . . But what is meant by the term? The material fact was that the carriage when not in use was kept in the building described as its ordinary place of deposit. The words which are used must be construed with reference to the property to which they applied. Carriages which are kept for sale and are insured as contained in a single warehouse could not be removed to a different warehouse without voiding the policy. There is nothing in the nature of the property to indicate that they will be removed and the insurance is not made with reference to such facts. But where a person procures a policy (as in this case) on horses, harnesses, and carriages as contained in a certain place, the presumption must be that they are in use and that the policy is issued with reference to such use. . . . Each policy must be construed according to the intention of the parties as manifested by all its terms. We are of the opinion, therefore, that while the words 'contained in a specific place' are words relating to the risk and constituted a warrant that the carriage would continue to be contained in the place designated, they mean only that the specific place described was their place of deposit when not absent therefrom for temporary purposes incident to the ordinary uses and employment of the property."

As representing the other view, there may be mentioned the case of *Village of L'Anse vs. Fire Association of Philadelphia*, 119 Mich., 427. Here the village had insured all

its fire-extinguishing apparatus under a standard fire policy. The property was insured in a given building and "not elsewhere to wit." While being used to extinguish a fire the apparatus was completely destroyed, and the company denied the claim on the ground that the property according to the terms of the policy was covered only while located in the specified building. In deciding the case the court took a view opposite to that given by the Iowa court, and held that the words of the standard fire policy were unambiguous and not susceptible to a construction other than that which the words themselves impart. In other words, the court declined to take into account the fact that the property insured would temporarily be removed from its usual place of location in the course of its ordinary employment. Since the policy expressly covered the property only while in a particular building, it was held not to cover it when situated in any other location.

Concealment or Misrepresentation of Material Facts.

—The standard fire policy provides that: "This entire policy shall be void if the insured has concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof; or in case of any fraud or false swearing by the insured touching any matter relating to this insurance or the subject thereof, whether before or after a loss." Following this clause many acts are mentioned which, unless allowed by agreement endorsed on the policy, will make the entire policy void. This section of the policy draws attention to the importance of furnishing the company with a correct statement of the description of the property either before or after a loss, as well as a true statement of the insurable interest which the insured possesses in the property covered. As stated before, the fire insurance contract must be viewed strictly as a personal contract which in-

sure the owner of the property rather than the property itself. In fact, there are few contracts in which one party, the company, is so absolutely at the mercy of the other party as in fire insurance. For this reason the *entire policy* is justly held to be null and void in the case of misrepresentation or fraud.

Doctrine of the Entirety of the Contract.—Aside from the previous phase, the above clause, relating to concealment, misrepresentation and fraud, also directs attention to an important doctrine in fire insurance, usually designated the doctrine of the “entirety” or “inseparability of the contract.” This doctrine applies in cases where more than one item of property is insured in the same policy. It is a very frequent occurrence that several items of property, such as several buildings, or the building and the stock of goods within the building, are covered by the same policy. Where this is done, it has been held by the courts in the great majority of states that if the premium is paid in one sum the policy is to be considered as a unit and as inseparable. This means that if a policy covering several items of property is violated as regards one of the items the policy will also be null and void as regards all the other items.

Numerous cases may be cited to illustrate the operation of this doctrine. One of the most widely quoted cases upholding the doctrine is that of *McQueeney vs. Phoenix Insurance Company*, 52 Arkansas, 257. According to the facts of this case, the Phoenix Insurance Company insured two buildings under one policy, the policy containing a clause that if, during the term of the insurance, the above mentioned premises should become vacant or unoccupied, except as specifically agreed in writing upon the policy, then the policy should cease during the period of vacancy or unoccupancy. At the time of the fire one of the dwellings was occupied, whereas in the

other no one was living. Both properties were destroyed. The insurance company acknowledged its liability on the building that was inhabited and paid the loss, but claimed that the policy was void with respect to the vacated building. The insured, on the other hand, took advantage of the doctrine of the entirety of the contract and maintained that the two dwellings were insured under one indivisible contract, and that if the company acknowledged liability for the loss of one of the buildings it therefore was also liable for the loss of the other. This was the view taken by the court. In all probability, if the company had refused payment on both of the buildings, it would have been absolved by virtue of this same doctrine from liability on both risks.

Again, in the case of *Gottzman vs. Pennsylvania Insurance Company*, 56 Pa., 210, the policy covered two items of property, namely, a building and the personalty within the building. The policy contained a provision to the effect that the company must be informed of certain incumbrances on the property. It happened that, in this connection, the owner of the property had incumbrances on the building unknown to the company, but had not violated the policy with reference to the personalty insured. Both items were destroyed, and the insured, while admitting that he was not entitled to any indemnity for the building, attempted to collect the value of the personalty, arguing that he had not violated the policy with respect to this item. The court, however, did not allow the claim, holding that the contract was a unit, and that if violated in respect to any one item it was also violated as regards all the others.

In recent years certain courts have emphasized the view that a policy of insurance should be interpreted with reference to the purpose of the contract. Thus, in the case of the *Connecticut Fire Insurance Company vs.*

Tilley, 88 Va., 1024, the court did not permit the application of this doctrine. In this instance, the policy covered sixteen tenement houses and contained the usual vacancy clause. At the time of the fire, eight of the houses were vacant and eight were occupied. The company claimed that, since the policy was inseparable, and since its provisions had been violated as regards some of the items insured, there was a forfeiture of the policy as to all the items. The court thought differently, however, and held that the indemnity was good as to those buildings which were occupied and void as to the others. "We think," said the court, "this decision substantially just to both parties, and in nowise conflicting with legal rules. There were sixteen different and distinct risks, all written as a matter of convenience in one policy. Under any other ruling the court would have been obliged to settle one way or the other, and this would have involved a gross injustice to one party or the other, and in no way have given legal effect to the well-understood intention of the fire insurance contract."

In criticizing the many court cases that have been rendered with reference to the doctrine of the entirety of the contract, it seems that the nature of the risk should be taken into consideration. If the several items covered under one policy are widely separated and not related to one another in such a way as to be lost in a single fire, it would seem fair to both insured and insurer that the doctrine of the inseparability of the contract should not apply. On the contrary, if the several items of property insured, such as a building and the contents within the building, are so related to one another that a fire in the one item will imply danger to the other, then it is clear that public policy should require the enforcement of the doctrine of the entirety of the contract. Not to do so would greatly increase the moral hazard. An example

may serve to illustrate the application of the doctrine of the entirety of the contract in instances of this kind. Thus let us assume that a person owns a building and stock within the building worth \$10,000 each, and that both are insured under the same policy for \$20,000. Let us now suppose that the owner procures additional insurance on the contents of the building for an amount greater than their value and without informing the first insurer. It is apparent that by allowing the owner to thus increase the insurance on his personalty an increased moral hazard attaches to the entire property, because there is an inherent connection between the contents of the building and the building itself; if one catches fire the other is also likely to burn. Now if the policy is held to be divisible, and that part which relates to the building could not be forfeited by disobeying the terms of the policy as regards the personalty, the owner of the property might easily secure overinsurance on the personalty with a view to running the risk of not being discovered, and feeling that even if he were discovered he would still be sure of his indemnity on the other item. This would imply a wrong to the insurance company, since it would be deprived of the security which had been especially provided for by the terms of the policy.

Warranties and Representations.—Fire insurance policies sometimes contain words to the effect that if any application, survey, plan, or description of property be referred to in the policy, it shall be a part of the contract and be regarded as a warranty by the insured. This is done to give added force to the information furnished in any application, survey, plan, or description of the property, and to protect the company as fully as possible against fraud. The practice brings us to a distinction between “representations” and “warranties.” In probably no business is this distinction of such vital

importance as in insurance along all lines. Again and again the life insurance policy calls the attention of the insured, usually in large print, to the fact that his answers in the application blank shall have the effect of warranties, and are made a part of the contract. The marine insurance policy also abounds with provisions and endorsements which are declared to be warranties. Now why this emphasis? If a statement given by the insured is to be construed as a "representation," it need only be substantially correct, and before there can be a forfeiture the company must not only show that the statement was false, but that the falsehood was of material consequence, that is to say, was a material factor in inducing the company to accept the risk or to fix the rate. If, on the contrary, all statements are declared to be warranties, it means that they must be absolutely and literally true, and that there will be a forfeiture if the company can show that the statement was false, irrespective of the materiality of the same. By declaring the application blank or any plan or survey or description of the policy a warranty, the company relieves itself of the difficult burden of proving the materiality of the same, and its burden of proof is limited to showing that the statement was not correct. As is well stated in one case:¹ "The purpose in requiring a warranty is to dispense with inquiry, and cast entirely upon the assured the obligation that the facts shall be as represented. Compliance with this warranty is a condition precedent to any recovery upon the contract. It is, therefore, that the materiality of the thing warranted to the risk is of no consequence."

Owing to the great strictness with which warranties are interpreted, and the fact that certain companies have

¹ Fire Insurance Co. vs. Arthur, 30 Pa. St., 315.

taken undue advantage of the use of warranties in their policies, many courts are loath to construe statements as warranties unless expressly declared to be such in the policy. Wherever statements are not declared to be warranties, the courts give the benefit of the doubt to the insured, and will consider them as representations rather than warranties. Because of the hardship and injustice which the technical enforcement of a warranty might cause, a considerable number of states have also seen fit to enact statutes which declare warranties illegal in insurance policies. These statutes usually provide that: "Whenever the application for a policy of insurance contains a warranty clause of the truth of the answers therein contained, any misrepresentation or untrue statement in such application made in good faith by the applicant, shall not effect a forfeiture or be a ground of defense in any suit brought upon any policy issued upon the faith of such application, unless such misrepresentation or untrue statement relate to some matter material to the risk."² In other words, these statutes declare all statements made by the insured to be representations. They must, therefore, be proved material before their incorrectness will lead to a forfeiture of the policy.

² The law of Pennsylvania, 1885, p. 134.

CHAPTER VIII

THE RISK ASSUMED UNDER THE POLICY

Definition of the Insurer's Liability Under the Policy.

—Several sections of the standard fire policy prescribe the general nature of the risk insured and the extent of liability which a fire insurance company assumes. In the very first section of the policy it is stipulated that:

The Insurance Company, in consideration of the stipulations herein named and of \$ premium, does insure and legal representatives, to the extent of the actual cash value (ascertained with proper deductions for depreciation) of the property at the time of loss or damage, but not exceeding the amount which it would cost to repair or replace the same with material of like kind and quality within a reasonable time after such loss or damage, without allowance for any increased cost of repair or reconstruction by reason of any ordinance or law regulating construction or repair and without compensation for loss resulting from interruption of business or manufacture, for the term of from the day of 192.., at noon, to the day of 192.., at noon, against all DIRECT LOSS AND DAMAGE BY FIRE and by removal from premises endangered by fire, except as herein provided, to an amount not exceeding \$....., to the following described property while located and contained as described herein, or pro rata for five days at each proper place to which

any of the property shall necessarily be removed for preservation from fire, but not elsewhere, to wit:

(Here follows a blank space for the written description of the property.)

The "consideration" for which an insurance company promises to give indemnity includes not merely the money premium, but also the insured's promise to comply with all the stipulations of the policy. In fact, the policy further states that it "is made and accepted subject to the foregoing stipulations and conditions, and to the stipulations and conditions printed on the back hereof, which are hereby made a part of this policy, together with such other provisions, stipulations, and conditions as may be endorsed hereon or added hereto as herein provided." In view of the consideration as thus defined the company agrees to insure the property against all *direct loss and damage by fire*. The policy also expressly provides that the property is only insured while located and contained as described in the policy, and not elsewhere, although, as we have seen in the Chapter on "The Description of the Property," this part of the policy must be interpreted in various states with reference to the nature of the business or property which is to be insured. Still other portions of the policy carefully define the insurer's liability by stipulating:

(1) That the company is only liable to the extent of the actual cash value of the property at the time of loss or damage.

(2) That such value must be ascertained with proper deduction for depreciation.

(3) That such value shall not exceed the cost of repairing or replacing the property destroyed with material of like kind and quality within a reasonable time after the occurrence of the loss or damage.

(4) That such cost of repairs or replacement shall not

take into account any allowance for increased cost by reason of any ordinance or law regulating construction or repair.

(5) That the company shall not be liable for any compensation for loss resulting from interruption to business or manufacture.

(6) That the company shall be liable for direct loss and damage resulting from the removal of property from the premises endangered by fire.

(7) That liability is limited to the amount stipulated as constituting the face of the policy.

(8) That the protection afforded under the policy is extended "pro rata for five days at each proper place to which any of the property shall necessarily be removed for preservation from fire."

The Doctrine of Proximate Cause.—An explanation of the meaning of the restrictive word "direct" in the foregoing provision involves a discussion of the doctrine of proximate cause. It frequently occurs that the property damaged or destroyed is situated far distant from the place where the fire originated, and is reached by the fire spreading from one property to another. In such cases disputes will frequently arise as to who shall be liable for the loss, especially where the factor of negligence is involved. A case in point is that of *Atkinson vs. Goodrich Transportation Co.* (60 Wisc., 141). Here the transportation company was charged with having negligently set fire to property situated a long distance from the origin of the fire, the flames having spread from building to building, until they finally reached and destroyed the insured premises. The court, in its opinion, gave the following rule: "The true rule is that what is the proximate cause of the injury is ordinarily a question for the jury. It is not a question of science or legal knowledge. It is to be determined as a fact, in view of

all the circumstances of fact attending it. The primary cause may be the proximate cause of the disaster, though it may operate through successive instruments, as an article at the end of a chain may be moved by the force applied at the other end, that force being the proximate cause of the movement. . . . The question always is, was there an unbroken connection between the wrongful act and the injury, a continuous operation? Did the effects constitute a continuous succession of events so linked as to make a natural whole, or was there some new and independent cause intervening between the wrong and the injury? It must appear that the injury was the natural and probable consequence of the negligence or wrongful act, and that it ought to have been foreseen in the light of the attending circumstances." Again, as summarized by Ostrander, "the proximate cause is not the one which is nearest in time to the result, unless such cause be independent. That must be regarded as proximate which is primary, efficient, the one which is the cause of causes. That which is only incidental and contributing is in no sense responsible for the disaster."¹ If, in such cases, the insurance company pays the claim, it becomes subrogated to the rights of the original insured to reimburse itself through the collection of damages from the party whose negligence caused the loss. The company, however, must prove that the proximate or real cause of the loss was the negligence of the party from whom it wishes to collect damages.

Numerous cases arise, however, where the doctrine of proximate cause is not connected with the subject of subrogation, but must be used to determine the liability of the insurance company itself. This is well illustrated in the case of *The Lynn Gas and Electric Co. vs. The*

¹ D. Ostrander, "Law of Fire Insurance," p. 365.

Meriden Fire Insurance Company (158 Mass., 570). Here the plaintiff was insured for a large amount, under the Massachusetts standard fire insurance policy, against direct loss or damage by fire, and the policies of the several companies covered all the machinery and other property of the plant. It so happened that all the wires transmitting power from the building to other parts of the city emanated from a single wire tower, near which stood a waste-paper basket. In some way this basket caught fire, which fire was quickly extinguished, but not until the flames had come in contact with the mass of wires, thus producing a short circuit, which in turn affected certain pulleys and belts until all the machinery in the building was severely strained or wrecked. The fire had done little or no damage by actual burning, although the indirect damage reached large proportions. The companies, in a test case, denied liability, but the court held that the policies insured everything in the building. Quoting the court's ruling: "The defendants when they made their contract understood that the building contained a large quantity of electrical machinery, and that electricity would be transmitted from the dynamos, and would be a powerful force in and about the building. They must be presumed to have contemplated such effects as fire might naturally produce in connection with machinery used in generating and transmitting strong currents of electricity." It should be added that liability for the indirect consequences of fire is to-day very commonly assumed or eliminated through special arrangements between insured and insurer in the form of endorsements attached to the policy.

Doctrine of Proximate Cause in Marine Insurance.—

Unlike fire insurance, where fire is the only cause of loss under consideration, marine insurance affords a very different problem since the policy covers many perils, two

or more of which may have contributed to the loss. Moreover, the property may be covered by several policies, some of which protect against perils not covered by the others. The recent war has probably, more than any other equal period of time, furnished complicated instances of two or more perils appearing in connection with the same loss, thus often making it necessary to ascertain the efficient cause in order to determine which of two underwriters should pay the claim, viz., the underwriter who may have accepted the war hazard only, or the one who may have assumed only the ordinary marine risks prevailing in times of peace.

Before marine underwriters become liable the loss must be proximately caused by one of the perils covered by the policy. This means that the direct and immediate, instead of the remote, cause must be ascertained. As stated in the case of *Pink vs. Fleming*,² "The question, which is the *causa proxima* of a loss, can arise only where there has been a succession of causes. When a loss has been brought about by two causes you must, in marine insurance law, look only to the nearest cause, although the result would no doubt not have happened without the remote cause." Phillips defines the doctrine as follows: "In case of the concurrence of different causes, to one of which it is necessary to attribute the loss, it is to be attributed to the efficient predominating peril, whether it is or is not in activity at the consummation of the disaster."³

Meaning of "Loss and Damage by Fire."—Loss and damage by fire has reference only to losses which are the result of the actual ignition of the insured premises or of property near by. It is not necessary, however,

² For the facts of this case see Frederick Templeman's "Marine Insurance," Ch. III, "*Causa Proxima*," p. 53.

³ Willard Phillips, "Treatise on the Law of Insurance," Sec. 1132.

that fire should actually have come in contact with any part of the insured property. Thus where the insured property is damaged by water used in extinguishing a fire in an adjacent building, or where, because of fire in a neighboring building, the damage is caused by the falling of a wall, insurance companies have again and again been held liable, even though no part of the insured property was ever reached by the fire. On the other hand, fire does not include "heat of a degree too low to cause ignition," and insurance companies are not liable for loss or damage occasioned by overheating, so long as the fire which caused the excessive heat has not left its proper receptacle. "Loss or damage by fire" also includes damage caused by water used in preventing the destruction of the building and its contents; and, unless stipulated to the contrary in the policy, comprises loss by theft or damage, or breakage, resulting from the process of removing goods in order to save them from destruction.

Excluded Risks.—Unless the policy contains provisions to the contrary, fire insurance companies are held liable for loss or damage by fire occasioned by any cause not expressly excepted in the policy. In view of this general rule, and for the purpose of protecting the company against undesirable risks, the standard fire policy contains the following provisions, outlining ten types of circumstances under which the company disclaims liability for loss or damage, unless otherwise provided by agreement in writing attached to the policy:

This Company shall not be liable for loss or damage caused directly or indirectly by invasion, insurrection, riot, civil war or commotion, or military or usurped power, or by order of any civil authority; or by theft; or by neglect of the insured to use all reasonable means to save and preserve the property at and after a fire or when the property is endangered by fire in neighboring premises.

Unless otherwise provided by agreement in writing added hereto this Company shall not be liable for loss or damage occurring:

(a) while the insured shall have any other contract of insurance, whether valid or not, on property covered in whole or in part by this policy; or

(b) while the hazard is increased by any means within the control or knowledge of the insured; or

(c) while mechanics are employed in building, altering or repairing the described premises beyond a period of fifteen days; or

(d) while illuminating gas or vapor is generated on the described premises; or while (any usage or custom to the contrary notwithstanding) there is kept, used or allowed on the described premises fireworks, greek fire, phosphorus, explosives, benzine, gasoline, naphtha or any other petroleum product of greater inflammability than kerosene oil, gunpowder exceeding twenty-five pounds, or kerosene oil exceeding five barrels; or

(e) if the subject of insurance be a manufacturing establishment while operated in whole or in part between the hours of ten P.M. and five A.M., or while it ceases to be operated beyond a period of ten days; or

(f) while a described building, whether intended for occupancy by owner or tenant, is vacant or unoccupied beyond a period of ten days; or

(g) by explosion or lightning, unless fire ensue, and, in that event, for loss or damage by fire only.

Unless otherwise provided by agreement in writing added hereto this Company shall not be liable for loss or damage to any property insured hereunder while incumbered by a chattel mortgage, and during the time of such incumbrance this Company shall be liable only for loss or damage to any other property insured hereunder.

If a building, or any material part thereof, fall except as the result of fire, all insurance by this policy on such building or its contents shall immediately cease.

Some of the aforementioned provisions will serve as the basis for later chapters and need not be amplified at this time. A few words of explanation, however, are necessary to show why certain of the foregoing risks are expressly excluded by the policy. The reasons, briefly stated, are as follows:

— (1) Loss resulting from invasion, insurrection, riot, civil war or commotion, or military or usurped power, etc., are not covered by the standard policy, partly because they are usually extraordinary losses occurring under conditions which make the extinguishment of fire difficult and partly because, in most cases, they may be recovered from the state or municipality.

(2) Loss through theft in the process of removing goods is expressly eliminated, because it is especially hazardous from the standpoint of the moral hazard.

(3) Loss by explosion must be distinguished from that caused by the subsequent fire, and the courts have repeatedly held that a fire and an explosion risk are inherently different. Therefore, the standard fire policy provides that the company shall not be liable for loss by explosion of any kind, unless fire ensues, and in that event for the damage by fire only. This rule at times presents difficult cases for adjustment, because where a fire immediately follows an explosion it is frequently impossible to determine the amount of loss occasioned by the explosion, as separate from the loss caused by fire.

(4) Loss by lightning is not covered by the policy unless the risk has been specifically assumed by an agreement endorsed on the policy, except where fire results from the lightning, and then, as in the case of explosion, the company's liability is limited to the damage occasioned by the fire. The agreement endorsed on the policy, which is called the "lightning clause," usually reads as follows:

“This policy shall cover any direct loss or damage caused by lightning (meaning thereby the commonly accepted use of the term lightning, and in no case to include loss or damage by cyclone, tornado, or windstorm) not exceeding the sum insured nor the interest of the insured in the property, and subject in all other respects to the terms and conditions of this policy.”

(5) Loss in case the building, or any material part thereof, has fallen, except as a result of fire, is not covered by the policy on the theory that when the insured building has fallen in part or in whole, it is no longer the original building which burns but simply the débris.

Excluded Articles.—Lines 7 to 9 of the standard policy provide against the insuring of a list of enumerated articles, which in most cases are evidences of ownership, and, therefore, not inherently valuable. The policy reads: “This policy shall not cover accounts, bills, currency, deeds, evidences of debt, money, notes or securities.” These articles are not insured, partly because they afford opportunity for fraud, being subject to easy concealment; and partly because the determination of the value of these articles is difficult, the company being obliged, in most cases, to depend upon the statement of the insured.

Another group of articles, mentioned in lines 9 to 11 of the policy, is of such a nature that the companies insure them only if liability is specifically assumed by endorsement on the policy. With respect to this group, the policy provides that “this policy shall not cover, unless specifically named hereon in writing, bullion, manuscripts, mechanical drawings, dies or patterns.” These articles, unlike the first group, possess inherent value, but it is apparent that this value is not easily determined and may be the subject of much dispute. Companies, therefore, before assuming liability for the loss of the same, may desire to prescribe special conditions.

Company's Liability for Loss Limited to the Actual Cash Value of the Property.—A very important provision of the standard policy is that which limits the company's liability to the actual cash value of the property at the time of the loss. This policy provision conforms with the true object of the fire insurance contract, namely, to furnish indemnity for the destruction of actual property values. In other words, even though the face value of the policy is for a larger amount, the insurance company should never, in the absence of a special agreement to the contrary, be held liable for more than the actual cash value of the property at the time of the fire. As explained in the chapter on "The Policy Contract," many causes operate to decrease the value of property during the interval between the time of the issuance of the policy and a loss. Again, it should be borne in mind that, even though values do not fluctuate, it is impossible for companies to make accurate inspections of the property at the time the risk is assumed. Experience shows that relatively few claims represent a total loss. Where partial losses occur, an adjustment must be made in any case. Is it not much more desirable, therefore, from the standpoint of expense, to defer a thorough investigation, as to actual value, to the few cases of total loss when the loss actually occurs, than to make the same at the time all these properties were insured?

Despite the fundamental principle of indemnity in fire insurance and the much greater economy in deferring careful examinations to the time of loss, it is most regrettable that nearly half of the states have seen fit to pass laws which, in the case of realty, make the company liable for the face value of the policy in case of a total loss. This type of legislation usually provides that every company insuring any building against loss, shall cause the same to be previously examined and to have its insurable value de-

terminated. The law further provides, as a rule, that in the absence of any increase in the risk without the consent of the insurer, in which the burden of proof shall be upon the company, and in the absence of intentional fraud upon the part of the insured, the company shall be liable for the whole amount mentioned in the policy in case of total loss. Such so-called "valued policy laws" are opposed to the very principles underlying fire insurance, and furnish a motive for fraud, resulting in the payment of dishonest claims out of the premium contributions of the honest. They have proved exceedingly expensive to policyholders of states which have enacted the same, and are sure to increase greatly the moral hazard.⁴

Company's Option to Rebuild or Replace.—Lines 176 to 184 of the standard policy read, "it shall be optional with this company to take all, or any part, of the articles at the agreed or appraised value, and also to repair, rebuild, or replace the property lost or damaged with other of like kind and quality within a reasonable time, on giving notice of its intention so to do within thirty days after the receipt of the proof of loss herein required, but there can be no abandonment to this company of the property described."

According to this provision, insurance companies may settle a claim by paying the loss, by taking all or any part of the property damaged or undamaged, or by repairing or replacing the property lost or damaged. When the company has elected one of these alternatives, its decision becomes an absolute agreement, and fixes the rights and duties of the parties. Insurance companies, however, do not desire to exercise the option of repairing or replacing the property unless they deem it absolutely necessary, as, for example, when a satisfactory adjustment of a loss can-

⁴See Dean's discussion of Valued Policy Laws, pp. 103-111 of "The Rational of Fire Rates."

not be made. Where the insured claims what the insurance company regards as an excessive demand, the company may determine whether it would not be cheaper to restore the goods or building to their original condition at the time of the fire. Certainly the insured cannot object to this. Since the cost of materials varies considerably at times, the insurance company may profitably exercise this option. In numerous states, however, disputes have arisen as to what constitutes a restoration, especially since the insurance company must replace the property with "other of like kind and quality," and the courts have been severe in their rulings against the companies. Partly for this reason and partly because insurance companies are not in the business of buying materials or constructing buildings, they prefer, whenever possible, not to exercise this option.

Abandonment of Property to Company Prohibited.—

Mention should also be made of the fact that in fire insurance, unlike marine insurance, the insured cannot abandon the property to the company and demand payment for the same. In marine insurance, if the facts warrant the construction of loss or damage into a total loss, the interests of the insured require that he should exercise his privilege of "abandoning" the risk to the underwriter. By this is meant that the insured claims payment for a total loss, and is willing to surrender to the underwriter all that remains of the insured property, including all proprietary rights which the insured originally had in the property. Such a practice is expressly forbidden in fire policies. Even where the courts, as in the case of city ordinances prohibiting the reconstruction of certain types of buildings when destroyed by fire to the extent of one-third or one-half, have shown a disposition to construe certain partial losses as equivalent to total losses, fire insurance companies have been prompt in nullifying such decisions through special policy provisions. As already

noted, the standard fire policy expressly provides that, in determining the company's liability, no allowance should be made "for any increased cost of repair or reconstruction by reason of any ordinance or law regulating construction or repair."

CHAPTER IX

TERM OF THE CONTRACT—RENEWAL AND CANCELLATION

Term of the Contract.—One of the necessary elements in any complete contract is an agreement as to the duration of the term. In fire insurance most contracts are written for one year or less, but the term is often made to extend over two, three, and five years, and even longer. The New York standard policy seeks definitely to state the limits of time within which the policy shall be in force by providing that the insurance shall extend “for the term of from the day of, 192., at noon, to the day of, 192., at noon.” The word “noon” is further defined in the policy as “meaning noon of standard time at the place of loss or damage.” Some have argued that a later hour than twelve o’clock would be more convenient, since then the termination of the policy could be made to coincide with the close of a business day. By invariable custom, however, all fire insurance policies are made to begin and end “at noon.”

As regards the beginning of the term, it is well settled in law that the policy takes effect on the day when it is applied for and dated. Any act of the company which signifies that it accepts the risk operates to complete the contract, and the actual delivery of the policy to the applicant is relatively unimportant. An excellent illustration of this principle is afforded in the case of the Hartford Steam Boiler Insurance Company vs. Lasher Stocking

Company, 66 Vt., 439. Here the defendant made application to the company on May 7th for insurance and the negotiations were conducted by mail. On May 13th the company mailed the policy, but inclosed an "exhibit" which recommended that certain changes be made on the premises. The policy was received by the defendant on May 15th, but regarding the suggestions of the company as mandatory, which they were not, he returned the policy on June 1st. On June 5th, the company returned the policy to the defendant and insisted on the payment of the premium, amounting by this time to \$100. The court was now called upon to fix the time when the policy began, and decided to the effect that "the law is now well settled that if an offer of a contract is made and accepted by letters, sent through the post, the contract is complete the moment the letter accepting the offer is posted, and this upon the ground that the post-office is regarded as an agent of the one making the proposition."

When policies cannot be delivered at once, it is common for the representative of the company to make the insurance binding in favor of the insured by issuing a so-called "binder" (see page 123). While not necessary legally to make insurance binding in the absence of the policy itself, the "binder" has the advantage of affording written evidence of the contractual relation between the parties. According to its terms, however, the binder terminates upon the issue of the standard policy in place thereof, or by twelve o'clock noon of the next business day after the risk is declined. Agents may legally bind insurance orally, but when doing so should confirm the same promptly in writing and also at once notify the company or companies.

In *Hallock vs. Commercial Union Insurance Company*, 26 N. J., 268, we have an instance where the insurer was held liable for a loss occurring before the contract was even accepted by the company. The application provided that

COPY OF BINDER

Name.....

Location.....

\$.....on.....

\$.....on.....

\$.....on.....

\$.....on.....

\$.....on.....

Address of Mortgagee-Payee or of Representative thereof:

Amount, \$..... Rate *..... Time.....Months.

Each of the undersigned companies, for itself only, insures the property above described for the amount set opposite its name until the issue of its Standard Policy on the same in place hereof, or until twelve o'clock noon of the next business day after the risk is declined, by notice to the insured or to the representative of the insured placing the risk; provided, however, that if the address of a mortgagee-payee or of a representative thereof is given above, such notice must also be sent to that address in order to terminate the insurance as to such mortgagee-payee. But in no event shall this insurance be in force over thirty (30) days from the date of commencement of liability hereunder.

* Subject to conditions of the 80% Reduced rate
90% average clause
100%

Binder Signed	Company	Amount	Date of Commencement of liability	Signature

if the risk proved acceptable the policy was to be antedated so as to be of even date with the application, namely, March 12th. On the next day the company mailed the policy to its agent to be delivered to the insured, but in the meantime, ten hours before the policy was actually written, the property was destroyed. Hearing of the loss, the company at once telegraphed its agent not to deliver the policy, which instruction was carried out, although the insured tendered the premium. The court held "that the contract was complete when the proposal was accepted, and that it became operative, in accordance with its own terms, at noon on the 12th day of March while the property was still in existence." It was further declared, "that it was competent for the parties to make contracts that should relate back, and be operative from the time of the beginning of the negotiations, or to any other period, there is no good reason for doubt." Contracts of insurance may also be made through the medium of the telegraph. An acceptance of a proposal by a telegram completes a contract and the time of completion is the time of delivery to the telegraph company.

A contract of insurance may also be issued in such manner as to cover property distantly located, although it has already been destroyed, provided the insured had no knowledge of its status.¹ In marine insurance it is a very common practice to insure property "lost or not lost," the underwriter agreeing to pay the loss, if it later develops that the property was destroyed prior to the date of the policy. Retroactive insurance of this kind, although rarely met with in fire insurance to-day, because of the promptness with which news can be obtained by modern methods of communication, may serve a very useful purpose in

¹ Illustrated by *Security Fire Insurance Company vs. Kentucky, etc. Insurance Company*, 7 Bush. (Ky.), 81 (1896).

protecting property in transit when the same is reported missing or has not been heard of for some time. The words "lost or not lost" need not, however, be contained in the policy. It is sufficient if it appears that the insurance was intended to cover prior losses.

By agreement, also, the parties to the fire insurance contract need not specify the date when the policy shall terminate, but may leave this to be determined by either party at will. When the date is thus left in blank, the policy is called an "open" one. Thus in marine insurance probably 90 per cent of all ocean cargo insurance is written on the "open policy cargo form." Nearly always, the termination of such policies is left indefinite, and in many instances the insurance runs continuously for years, the understanding being that either party to the contract may cancel the same at any time, subject to 30 days' notice. The legality of such an arrangement has often been upheld by the courts. Thus in one case,² it was decided that "the agreement that the risk should run from the first day of August, 1885, to a day to be named by the defendant is in law an agreement as to the duration of the risk, and is equivalent in law to a contract for a certain time, because under the terms of agreement, the time can be rendered certain."

Renewal of Contract.—Closely related to the term of the contract is the practice of renewal. Most standard policies at present make no reference to the subject, although it was customary at one time to include a clause providing "that this policy may by a renewal be continued under the original stipulations, in consideration of premium for the renewed term, provided that any increase of hazard must be made known to this company at the time of renewal, or this policy shall be void." The renewing of a

² *Imboden vs. Detroit, etc., Insurance Company*, 31 Mo. App., 321.

policy does not necessarily require the writing of a new policy, although this is nearly always the case to-day. The essential thing to be noted about a renewal policy is that, while in all particulars it should resemble the original contract, legally it is a new contract, which, unless expressed to the contrary, is subject to the terms of the original policy. Special privileges granted by the company under the original policy, but not a part of the contract, cannot be demanded under the renewal.

The description of the property, where a policy is renewed, must apply to the property as it stands at the time of renewal; and any increase of hazard, which is not disclosed, will work an avoidance of the new policy. The risk (description of property) insured under the original policy expires when the policy expires, and each renewal must be considered as applying to a new risk. With the exception of the description of the property, however, a renewal policy may be presumed by the holder to be in all respects like the original contract. As stated by Joyce, "the word renewal is synonymous with 'extended.' Where there is an agreement for renewal of a policy, the assured is justified in assuming premiums, terms, and conditions as of the original, unless he has notice of such change." Thus, suppose, for example, that the original policy contained no coinsurance clause, but that the renewal policy did. Suppose also that the policyholder, relying on the good faith of the company, failed to read the renewal policy. In the event of a loss, on what basis shall it be settled—with or without coinsurance? Justice would seem to dictate that in such a case the insured should be allowed to maintain an action for a reformation of the contract. In a case³ involving the precise facts assumed, the court per-

³Palmer vs. Hartford Fire Insurance Company, 54 Conn., 488.

mitted the reformation of the contract and declared "the plaintiff could not be regarded as guilty of laches in not examining the policy and applying earlier for its correction."

Attention may also be called to the practice of reinstating policies. In the event of a loss it is often desired to have the policy again cover for the original amount, i.e., have the policy reinstated for the amount of the loss. Where the losses are comparatively small this is usually done by means of some such endorsement as the following: "In consideration of \$. additional premium, loss amounting to \$. by fire of (date) is hereby reinstated, and policy is continued for the full amount, namely, \$."

Right of Cancellation and Reasons For.—Unless reserved in the policy, the right of cancellation does not exist, except by mutual consent. Under the provisions of the New York standard policy, however, both parties to the contract may cancel, lines 89 to 100 of the policy providing that "this policy shall be cancelled at any time at the request of the insured, in which case the Company shall, upon demand and surrender of this policy, refund the excess of paid premium above the customary short rates for the expired time. This policy may be cancelled at any time by the Company by giving to the insured a five days' written notice of cancellation with or without tender of the excess of paid premium above the pro rata premium for the expired time, which excess, if not tendered, shall be refunded on demand. Notice of cancellation shall state that said excess premium (if not tendered) will be refunded on demand." With respect to a mortgagee's interest, the policy makes further provision (lines 108 to 112) for a 10 days' written notice of cancellation. In several states the company is required to give 10 days' notice of cancellation to the insured, and in Wisconsin, although five

days' notice on the part of the company is sufficient under ordinary circumstances, provision is made for sixty days' notice during times in which the hazard shall be increased solely by the act of God. In any case, the right of cancellation reserved by the company cannot be exercised under circumstances which would operate as a fraud on the insured, where, for example, the company would serve notice of cancellation at a time when the property is threatened by an approaching conflagration.

Many reasons exist why the company should reserve the right to cancel the policy after giving due and timely notice. The company, subsequent to the issuance of the policy, may discover an undesirable moral hazard, or may become aware of a great increase in the physical hazard not considered when the policy was issued, such as changes in construction or processes of manufacture, or where a property is left vacant or in an unprotected condition. After a suspicious partial loss, the company may wish to relieve itself from further liability under the policy before a final settlement of the loss can be made. In many cases where the adjustment of a loss, which does not involve all the property covered by the policy, is delayed, companies consider it important that, pending the settlement, they should promptly relieve themselves from further liability on the remaining property described in the policy. Or the company may decide to retire from business and, therefore, desires to cancel all its policies. But whatever the reason for the cancellation of the policy, it is a well-established principle that neither the insured nor the company need offer any explanation for their decision to cancel.

Tender of Unearned Premium.—To legally effect a cancellation of the policy on the part of the company, the courts have held, in many instances, that there must be an actual tender of the unearned premium without conditions for the unexpired term. In other cases, however, it has

been held specifically that cancellation may be effected without such tender. The cancellation clause of the standard fire policy makes three distinct references to the subject, all expressing the company's option in the matter. The first reference states that the cancellation may be effected by the company "giving to the insured a five days' written notice *with or without* tender of the excess of paid premium above the pro rata premium for the expired time." The next reference declares that the "excess, *if not tendered*, shall be refunded on demand." Finally, the closing sentence of the cancellation clause once more stipulates that the "notice of cancellation shall state that said excess premium (*if not tendered*) will be refunded on demand." But while the policy appears to be very explicit in the matter, a tender of the unearned premium to the insured for the unexpired term is invariably attempted. The cancellation notice usually takes some such form as the following:

MEMORANDUM: CANCELLATION—PREMIUM
PAID

DEAR SIR:

In accordance with lines 94 to 100 inclusive of policy No., issued to you by the..... Company, covering on at, this Company hereby notifies you that it elects to cancel said policy.

Herewith we hand you \$., being an amount not less than the pro rata unearned premium for the unexpired term of such policy. In accordance with the conditions referred to all liability under this policy on the part of this Company will cease and terminate at the expiration of five days from the receipt by you hereof, and

we request that you kindly return the cancelled policy for our files.

Yours very truly,

Enc.

.....Insurance Company.

.....Agent.

Notice of cancellation may be given either personally or by mail. But to be certain of a legal cancellation, the company must be able to prove that the insured, or his legal representative, has actually received the notice of cancellation. Accordingly, the surest way of effecting a cancellation is to see the insured or his representative with a view to delivering the notice in person. But this cannot always be done, and dependence must often, therefore, be placed on the mails for transmission of the notice. If thus sent by mail, it is generally recommended that the letter be registered with a request for a registry return receipt signed by the insured or his legal representative. Since cancellation is held not to be completed until the unearned premium has actually been paid, it is also considered advisable in all cases to accompany the notice of cancellation with the amount representing such unearned premium.

Short-rate Tables.—As already observed, the standard policy provides that, in case the company cancels the policy, the unearned portion of the premium shall be returned in full. In case, however, the insured cancels the policy, the company need only “refund the excess of the paid premium above the customary short-rates for the expired term.” To do otherwise would enable a property owner to evade the proper charges for short risks, because if he could receive back all premiums on a pro rata basis he could take a policy for a year and cancel it when no longer wanted. As examples of the short-rates charged by fire insurance companies when policies are cancelled by the insured, the fol-

Following tables are cited for illustrative purposes, the first being that used by the Philadelphia Fire Underwriters' Association for one-year policies, and the second table used by the same Association for policies running longer than one year:

SHORT RATE TABLE FOR ONE YEAR POLICIES

Time, Days	Per- centage to be charged or retained	Time, Days	Per- centage to be charged or retained	Time, Days	Per- centage to be charged or retained
1	2	19	16	135	56
2	4	20	17	150 (5 mo.)	60
3	5	25	19	165	66
4	6	30 (1 mo.)	20	180 (6 mo.)	70
5	7	35	23	195	73
6	8	40	25	210 (7 mo.)	75
7	9	45	27	225	78
8	9	50	28	240 (8 mo.)	80
9	10	55	29	255	83
10	10	60 (2 mo.)	30	270 (9 mo.)	85
11	11	65	33	285	88
12	11	70	36	300 (10 mo.)	90
13	12	75	37	315	93
14	13	80	38	330 (11 mo.)	95
15	13	85	39	345	98
16	14	90 (3 mo.)	40	360 (12 mo.)	100
17	15	105	46		
18	16	120 (4 mo.)	50		

SHORT RATE TABLE FOR TERM POLICIES

Percentage to be Charged or Retained								
Time, Months	Two Year Policy written at		Three Year Policy written at		Four Year Policy written at		Five Year Policy written at	
	1½ An- nuals	1½ An- nuals	2½ An- nuals	2 An- nuals	3½ An- nuals	2½ An- nuals	4 An- nuals	3 An- nuals
1	11.	13.	8.	10.	6.	8.	5.	7.
2	17.	20.	12.	15.	9.	12.	8.	10.
3	23.	27.	16.	20.	12.	16.	10.	14.
4	29.	33.	20.	25.	15.	20.	13.	17.
5	34.	40.	24.	30.	18.	24.	15.	20.
6	40.	47.	28.	35.	22.	28.	18.	24.
7	43.	50.	30.	38.	23.	30.	19.	25.
8	46.	53.	32.	40.	25.	32.	20.	27.
9	49.	57.	34.	43.	26.	34.	21.	29.
10	51.	60.	36.	45.	28.	36.	23.	30.
11	54.	63.	38.	48.	29.	38.	24.	32.
12	57.	67.	40.	50.	31.	40.	25.	34.
13	61.	70.	43.	52.	33.	42.	27.	35.
14	64.	72.	45.	54.	35.	43.	28.	36.
15	68.	75.	48.	56.	37.	45.	30.	38.
16	71.	78.	50.	58.	38.	47.	31.	39.
17	75.	81.	53.	60.	40.	48.	33.	40.
18	79.	83.	55.	63.	42.	50.	34.	42.
19	82.	86.	58.	65.	44.	52.	36.	43.
20	86.	89.	60.	67.	46.	53.	38.	44.
21	89.	92.	63.	69.	48.	55.	39.	46.
22	93.	94.	65.	71.	50.	57.	41.	47.
23	96.	97.	68.	73.	52.	58.	42.	49.
24	100.	100.	70.	75.	54.	60.	44.	50.
25	....	....	73.	77.	56.	62.	45.	51.
26	....	....	75.	79.	58.	63.	47.	53.
27	....	....	78.	81.	60.	65.	48.	54.
28	....	....	80.	83.	62.	67.	50.	56.
29	....	....	83.	85.	63.	68.	52.	57.
30	....	....	85.	88.	65.	70.	53.	58.

SHORT RATE TABLE FOR TERM POLICIES—*Continued*

Percentage to be Charged or Retained								
Time, Months	Two Year Policy written at		Three Year Policy written at		Four Year Policy written at		Five Year Policy written at	
	1½ An- nuals	1½ An- nuals	2½ An- nuals	2 An- nuals	3½ An- nuals	2½ An- nuals	4 An- nuals	3 An- nuals
31	88.	90.	67.	72.	55.	60.
32	90.	92.	69.	73.	56.	61.
33	93.	94.	71.	75.	58.	63.
34	95.	96.	73.	77.	59.	64.
35	98.	98.	75.	78.	61.	65.
36	100.	100.	77.	80.	63.	67.
37	79.	82.	64.	68.
38	81.	83.	66.	69.
39	83.	85.	67.	71.
40	85.	87.	69.	72.
41	87.	88.	70.	74.
42	88.	90.	72.	75.
43	90.	92.	73.	76.
44	92.	93.	75.	78.
45	94.	95.	77.	79.
46	96.	97.	78.	81.
47	98.	98.	80.	82.
48	100.	100.	81.	83.
49	83.	85.
50	84.	86.
51	86.	88.
52	88.	89.
53	89.	90.
54	91.	92.
55	92.	93.
56	94.	94.
57	95.	96.
58	97.	97.
59	98.	99.
60	100.	100.

CHAPTER X

“OTHER INSURANCE” AND “CONTRIBUTION”

Definition of Other Insurance.—The term “other insurance” (sometimes also referred to as “double insurance,” “multiple insurance” and “over-insurance”) refers to the existence of more than one policy upon the same interest in the same subject of insurance. Three fundamental ideas underlie the concept of other insurance. The insurable interest, represented by the several policies, must be the same. Thus the mortgagor and mortgagee, having different interests, may both insure the same property, the former to its full value and the latter to the extent of his interest. Again, the several policies must cover at least a part of the same subject of insurance. Thus two policies, one insuring the building and its contents and the other the contents only, come within the meaning of other insurance. The third requirement, relating to marine insurance which covers many perils, is that the several policies must assume the same hazards. Thus, one marine policy may grant protection against all marine perils prevailing during times of peace, another may cover against war hazards only, another may assume full coverage comprising both partial and total loss, and still another may extend protection against total loss only. All these policies apply to the same subject of insurance, and yet will not constitute other insurance since they all assume distinctly different hazards.

Purpose of Policy Provision Relating to Other Insurance.
—With respect to other insurance, most standard fire policies

contain the following provision: "Unless otherwise provided by agreement in writing added hereto, this Company shall not be liable for loss or damage occurring while the insured shall have any other contract of insurance, whether valid or not, on property covered in whole or in part by this policy." This clause, or one very similar to it in wording, is found in every modern fire insurance policy. Its object is not to prevent different persons from insuring their respective interests in a given property, but simply to make impossible the taking out of more than one policy on a single interest in the same subject matter, except with the knowledge and sanction of the insurer. It is necessary to emphasize the importance of using as much caution in restricting the total amount of insurance written on a property under a number of policies as when all the insurance is carried under one policy. The clause has been declared reasonable and valid. It is important to the company, in that it makes over-insurance difficult, and greatly lessens the moral hazard. It is effective in removing the incentive to destroy property for dishonest gain, and thus aids in preserving the principle of indemnity in fire insurance irrespective of the number of policies covering the same interest. Because of the general use of the clause, incendiarism is lessened, and the public is benefited by a decrease in the loss resulting from gross carelessness or dishonesty on the part of property owners who know that their property is more than fully insured.

Many cases exist where it would be unduly harsh to prevent the insured from supplementing his existing policies with additional insurance. This may be done, but only with the sanction of all the insurers already on the risk. Two methods are available. When the insured is reputable and the additional insurance is justified, the companies will readily grant the request for additional insurance. Or the insured may have his policies endorsed in advance with

a permit allowing other insurance at will. In fact, such permits are freely granted where the character of the policyholder justifies such treatment, and are necessary in many lines of business. The wording used in connection with such permits varies, but usually takes some such form as: "Privilege granted for other insurance," "other concurrent insurance permitted," or "other concurrent insurance permitted to the extent of \$. only."

History of the Clause—Significance of the Words, "Valid or Invalid."—The development of the "other insurance" clause in fire insurance is interesting, and may be divided into three stages. Originally no provision was made in the policy against the taking of other insurance, and the policyholder could procure as much insurance as he desired. In case of loss he could exercise the option of collecting his insurance from any one or more of the several insurers. The insurer selected would in turn seek reimbursement from the other underwriters on the risk. The principle, however, was strictly adhered to that fire insurance is indemnity, and that the insurers were never liable for more than the actual loss. Later, when "other insurance" clauses first came into use, they were worded so as to exempt the insurer from liability in case no notice was given of prior insurance. Subsequent insurance, however, would not invalidate the policy, and in determining the priority or subsequence of different policies, fractions of a day were considered.

When insurance became more general, and the necessity for carefully restricting other insurance was more apparent, the "other insurance" clause was so worded as to prohibit the procuring of additional insurance, except when permitted, whether it was "prior, concurrent, or subsequent." This clause apparently would seem to cover all contingencies, yet it was not long before three distinct lines of court decisions developed in the different states. In one group

of states, like Massachusetts and Pennsylvania, the courts held that the prior insurance was valid on the ground that the subsequent policy never really had an existence, because of the provision against other insurance which it contained. Since the subsequent policy could not come into existence, it therefore followed that the prior policy was not invalidated. Another group of courts took the view that the subsequent policy, whether it could be enforced or not, did invalidate the prior policy. And, lastly, a middle view was taken in the state of Iowa, according to which the validity of the prior policy depended upon whether or not the subsequent policy was recognized as valid by the company which wrote it. If the subsequent policy was declared by the insurer to be valid, the prior policy would be invalid because its provision against other insurance was violated by the taking of the subsequent insurance. On the contrary, if the insurer did not recognize the subsequent policy, the prior policy was declared to be valid, because no other policy existed to violate its stipulation against other insurance.

Whatever might be thought of the wisdom or correctness of these conflicting views, it is certain that the companies could not afford to leave in doubt the meaning of this important provision of the policy. To remove all ambiguity, the "other insurance" clause of the standard policy was especially worded so as to overcome the conflicting decisions of the courts. It will be noted that the clause provides that the entire policy shall be void if the insured "shall have any other contract of insurance, *whether valid or not*, on property covered in *whole* or in *part* by this policy." As it now stands, the clause has, with very few exceptions, been given full force by the courts. As stated by Richards:¹

¹ Richards: "Treatise on the Law of Insurance," p. 323.

"Much doubt would seem to be removed by the insertion, as in the New York standard form, of the words 'valid or invalid,' to which force must be given; and when the policy in suit contains them, it should be held vitiated by other insurance, whether regarded as void or voidable, provided no written consent to the other insurance has been obtained. In a suit on either policy with such a clause the insured is unable to establish his case by virtue of the excuse that the other policy is invalid. And insurance taken out simultaneously with the policy in suit is equally in violation of the warranty."

Significance of the Words "Covered in Whole or in Part."—In the absence of such wording in the policy, certain courts hold that where one policy covers only part of the property insured by the other, the two policies do not legally cover the same subject-matter, and, therefore, do not legally present a case of other insurance. The present wording, however, expressly declares that the entire policy shall be void if other insurance exists on either all or a part of the property covered by the insurer whose consent for the other insurance was not obtained. As an illustration, let us assume that the owner of a building and its contents has both items insured under one policy, and later takes out another policy on the contents, without obtaining the permission of the companies involved. By this act both policies are forfeited, because by the policy wording the procuring of insurance on one of the items, in this case the contents, will also render void the insurance on the building.

Y
no
violation **Other Insurance in Relation to Renewal and Substitution.**—A brief explanation should also be given here of the relation of "other insurance" to the renewal and substitution of policies. If other insurance has been permitted, and the additional policy is renewed later without the consent and knowledge of the company, it is generally con-

sidered not a violation of the other insurance clause, although in some states a contrary opinion prevails. Likewise, if the additional insurance, which has been permitted by the company, is canceled or allowed to expire, and an equal or smaller amount is secured in another company to take its place, no violation of the other insurance clause is, by the weight of legal opinion, considered to have taken place.

The Other Insurance Clause in Marine Insurance.—At this point reference may be made to the fact that the practice of arranging for other insurance in American marine insurance is totally different from that just explained. The clause common to marine policies issued by American companies reads as follows:

“Provided always, and it is hereby further agreed, that if the said assured shall have made any other insurance upon the property aforesaid prior in day of date to this policy, then the said Insurance Company shall be answerable only for so much as the amount of such prior insurance may be deficient towards fully covering the property hereby insured. And the said Insurance Company shall return the premium upon so much of the sum by them insured as they shall be by such prior insurance exonerated from. And in case of any insurance upon the said property subsequent in day of date to this policy, the said Insurance Company shall nevertheless be answerable for the full extent of the sum by them subscribed hereto, without right to claim contribution from such subsequent insurers, and shall accordingly be entitled to retain the premium by them received, in the same manner as if no such subsequent insurance had been made. Other insurance upon the property aforesaid of date the same day as this policy, shall be deemed simultaneous therewith; and the said Insurance Company shall not be liable for more than a ratable contribution in the proportion of the sum by them insured to the aggregate of such simultaneous insurance.”

This clause is peculiar to American marine policies. It simply serves to state the respective liabilities of two or more underwriters who may have insured the same subject-matter. The basis for the determination of the liability is the order of the day of date of the contract involved. If the policy in question has been written subsequent in day of date to another policy, the latter (or prior policy) will assume all of the liability until it is exhausted. The policy in question (the subsequent policy) will therefore only assume the balance of loss which the prior policy, owing to the fact that it was deficient in amount, could not pay. Vice versa, if the policy in question happens to be prior in day of date to another policy, it is agreed that it shall alone assume liability for loss until it is exhausted, the subsequent policy not sharing in the loss until that time. Should there be three or more policies, all different in day of date, each policy would have to be exhausted in the order of its date before the next subsequent policy would become liable. But where two or more policies are simultaneous in day of date, and the combined insurance carried under all the policies exceeds the loss incurred, then each policy will contribute to the loss in the proportion that its insurance bears to all the insurance involved. Moreover, where the policy in question is freed from the payment of a claim, because a prior policy assumes the loss, the underwriter agrees to return the premium on the amount which represents the over-insurance. But the entire premium may be retained when the policy in question is the prior one; and where several simultaneous policies contribute to a loss, each underwriter may retain his pro rata portion of the premium.

Contribution
Contribution in Fire Insurance.—"Contribution" and apportionment of loss among different underwriters, where several fire insurance policies have been writ-

ten on the same interest, involves some of the most important and, at the same time, most perplexing problems to be met with in the adjustment of losses.² Lines 102 to 105 of the New York standard fire policy provide that "this Company shall not be liable for a greater proportion of any loss or damage than the amount hereby insured shall bear to the whole insurance covering the property, whether valid or not and whether collectible or not."

Apportionment of Loss when the Policies Are Concurrent.—Where the several policies covering the same interest are alike in all their terms, i.e., are "concurrent," the application of the foregoing rule is a simple matter. For the purpose of explanation, let us assume that the owner of a property valued at \$40,000 has the same insured to the extent of 80 per cent of its value, or \$32,000, in three different companies as follows: in Company "A" \$8,000, in Company "B" \$10,000, and in Company "C" \$14,000. Now let us assume that a loss of \$10,000 occurs. If all the policies agree in their wording, and cover the same interest, it follows from the contribution clause just quoted that each insurer is liable for the payment of only a pro rata proportion of the \$10,000 loss. Since Company "A" carried only \$8,000 of insurance on the risk, it will not be liable for a greater proportion of the \$10,000 than the amount of its insurance (\$8,000) bears to the whole insurance on the property (\$32,000), or one-fourth. In the same way Company "B" will only be liable for 10/32 of the \$10,000 loss, i.e., the proportion

² The best discussion of contribution, involving an explanation of the various rules for apportionment of losses, and a statement of the principal legal decisions, is contained in W. H. Daniel's "The Apportionment of Loss and Contribution of Compound Insurance." Excellent discussions, from a legal standpoint, are also found in Ostrander's "The Law of Fire Insurance," and in Richards' "Treatise on the Law of Insurance."

that its insurance, \$10,000, bears to the total insurance of \$32,000. Company "C's" liability will be limited to 14/32. Company "A," therefore, will pay \$2,500 of the loss, Company "B" \$3,125, and Company "C" \$4,375.

Significance of the Words "Whether Valid or Not and Whether Collectible or Not."—Special mention should be made of that section of the contribution clause, which provides for pro rata apportionment among all the policies, "whether valid or not and whether collectible or not." Such wording avoids many troublesome questions as to the validity of policies and the solvency of companies that would frequently arise where a number of policies cover the same property and which would have to be settled before the loss could be apportioned. But by expressly declaring that invalid policies, or policies issued by insolvent companies, must contribute just like the valid and solvent ones, it is possible to avoid the expense and delay usually connected with any inquiry into the validity of policies or the solvency of companies. This part of the contribution clause is also of the greatest importance to the property owner who may rely upon the chance that he will suffer only a partial loss, and may, therefore, feel that he can afford, in part at least, to take cheap insurance in an unreliable company. If the policies of insolvent companies were not considered as contributing with those of the solvent companies, it would follow inevitably that property owners, who are constantly on the lookout for cheap insurance, would take part of their insurance in reliable companies charging adequate rates, with a view to covering their partial losses, and then, as a protection against unusual losses which they hardly expect, would take other insurance in doubtful companies charging inadequate rates. The contribution clause as it stands, however, gives fair warning to property owners that such a practice can prove

of no benefit because, whether the loss be partial or total, all policies in companies unable to pay will be considered as contributing on a pro rata basis with those issued by solvent insurers. If in the foregoing illustration Company "C" should have been able to pay only 50 cents on the dollar, it would, nevertheless, be considered as having contributed $\frac{14}{32}$ of the \$10,000 loss. Companies A and B, despite the insolvency, would pay only their respective proportions of $\frac{1}{4}$ and $\frac{5}{16}$ of the loss, and the property owner would be the loser of one-half of Company C's liability, or \$2,187.50.

Contribution when the Policies Are Non-current.—As contrasted with the foregoing, much greater difficulties present themselves in the apportionment of a loss when two or more policies are issued on the same interest and are "non-current," i.e., do not agree in their terms. As sometimes happens, a number of policies may be written on the same interest, and may differ as to the description of the property, one policy insuring the building, another covering the building and furniture, and still another insuring the furniture and general merchandise. Or it may happen that certain policies are "specific," and cover only one item of property, whereas other policies are "general" (sometimes called "blanket" policies or "compound" policies), and cover all the items under one sum. Again, it may happen that the policies on a given interest do not agree as regards important endorsements, one policy, for example, containing a three-quarters' loss clause and another containing no such limitation. Policies may also be non-concurrent in that they differ (1) as to the location of the various items covered, or (2) because the interests insured are not the same. Non-concurrent policies are usually the result of carelessness on the part of the agent, and in case of loss always result in much dissatisfaction. Companies instruct their agents, in order

to avoid the issuing of such contracts, to refuse a policy where the insured declines to make known the wording of policies already covering the property. And where the nature of the other policies is revealed and they are found to vary in their wording, it is deemed best to have their terms so changed that they will be concurrent with the new insurance. Agents are also warned to make the written portions of all policies alike. Through their underwriters' associations, the companies also aim to use uniform printed endorsements. Through the same associations they also operate so-called "stamping departments" to which agents must refer all policies for examination and approval. Here the policies are carefully checked with reference to their endorsements and descriptive matter, with the result that much of the difficulty formerly connected with non-concurrent insurance is now avoided.

Unless effective methods of this kind are adopted, hopeless confusion will arise which no system of apportionment can solve accurately. In most instances the companies have sought to adjust cases of non-concurrency outside of the courts through the application of some arbitrary rule. Where the courts have undertaken to prescribe a method of settlement, the attempt usually has been far from satisfactory. A study of the court decisions shows that, as a rule, when a case of apportioning a loss among non-concurrent policies was brought up for consideration, only two plans were considered by the court, namely, "the two rules of apportionment contended for by the parties to the suit." The court would attempt to place the different policies as much as possible upon a footing of equality, and would approve that rule of apportionment which would pay the insured the full amount of the loss. As stated by Daniels, "the courts have repeatedly decided that if the insured has as much

or more insurance than the amount of loss, his loss must be paid in full, and no rule of apportionment which fails to pay the loss in full will be recognized by the courts."

Illustration of Apportioning Compound Insurance.—

To arrive at the amount payable under each of several non-concurrent policies, it is necessary to observe two distinct steps, namely, (1) the *apportionment* of the insurance, and (2) the determination of each policy's *contribution* to the loss. In other words, it is first ascertained what portion of the face value of each policy applies to the risk on which the loss has occurred, and secondly, what proportion of the total indemnity is due under the terms of each.

Of the many rules devised, one may be used for illustrative purposes. The so-called "Reading Rule," for example, stipulates that the compound policy (the policy covering more than one item) shall apply to each item on which there is a specific policy (a policy covering the one item only) in the proportion that the value of the specific item bears to the value of all items covered by the compound policy. This rule may be illustrated by the case of *Page vs. Sun Insurance Office* (74 Fed. Rep., 194). Here the court was called upon to apportion the loss among policies which were non-concurrent as regards the location of the property. Reducing the figures to even thousands the facts were as follows:

Value of the property	Insurance	Loss
West yard... \$40,000	Four specific policies on	\$2,500 West yard... \$30,000
East yard... 20,000	West yard only.....	2,500
	One general policy on both yards..	2,500
		2,500
		<hr/>
	Total.....	\$50,000

The question involved was: How should the loss of \$30,000 be apportioned between these five policies, one a general policy on all the property, and four specific policies covering the property in the West yard only? According to the contention of the underwriters issuing the specific policies, the total insurance on the West yard consisted of the \$40,000 general policy and the \$10,000 of specific insurance, or \$50,000 in all. If this reasoning was to be followed, the general policy would pay the \$30,000 loss in the proportion that its insurance (\$40,000) bore to the entire insurance (\$50,000), or four-fifths (\$24,000), and each of the specific policies would pay only \$1,500 or \$6,000 in all. On the other hand, however, the underwriter issuing the general policy contended that his policy of \$40,000 applied to the property in the West yard only to the extent that the value of property in the West yard, \$40,000, bore to the total value of all the property in both yards (\$60,000), i.e., only to the extent of four-sixths of \$40,000, or \$26,666.66. This latter plan was the one adopted by the court as the most equitable. It is clear that under this line of reasoning the liability of the specific policies was considerably increased beyond what would have been the case had the general policy been obliged to contribute for its full amount on the value of the property in the West yard.

Numerous Rules in Use for the Apportionment of Loss Among Compound and Specific Policies.—The difficulties which present themselves in the apportionment of losses, when some of the policies are “specific” and others are “compound,” are well illustrated by the case submitted for solution to Mr. W. H. Daniels.³ According to the case, the Continental Insurance Company insured \$2,500 on

³ Another excellent summary of the various rules in use is furnished by Mr. Willis O. Robb and published in George Richards' "Treatise on the Law of Insurance."

wheat, \$3,000 on corn, and \$2,000 on oats, or a total insurance of \$7,500. Two other companies, however, the *Ætna* and *Home*, insured \$5,000 and \$6,000 respectively on "grain." The value of the wheat, corn, and oats was respectively \$8,000, \$7,000, and \$10,000; and the loss on these three items in the order given was \$3,000, \$4,000, and \$8,000. Now what should be the method of apportioning this loss among the several policies, and how much should be paid under each?

In answering this question, Mr. Daniels makes the following introductory statement:

"You may not fully realize the importance of the proposition you have submitted to me for my consideration. It involves some of the most intricate questions we find in the adjustment of losses, and for many years such cases as you have submitted have been the source of serious anxiety in the loss departments of the various insurance companies, and have been the basis for a large number of contests before the courts. The insurance men of the past, and of today, who were, and are, because of their interest and work in the adjustment of loss claims, thoroughly posted, have not agreed and do not agree what each company should pay in such a case as you have submitted. Similar cases have received the attention of the courts during the past fifty years, and it is safe to say that the decisions of the courts as to how the losses in your case should be apportioned among the companies are not in harmony."

In discussing the solution of the aforementioned problem, Mr. Daniels devotes a volume to the application of the many rules of apportionment used in different localities, and shows that each will result in different amounts being paid under the several policies involved. Space limits forbid a detailed presentation of the many rules discussed. The following, however, may be mentioned as illustrative of some of the methods used:

Contribution according to value: "Compound insurance shall contribute with specific in proportion as the value of the specific property bears to the value of all the property covered by the compound policy." (Daniels, p. 7. This rule was previously described as the Reading Rule.)

Contribution according to the order of description of the several items of property: "The compound insurance contributes from its full amount with the specific, to pay the loss on the first item in the general form on which there is a loss. The remainder of the compound insurance, after deducting amount of loss paid, contributes with the specific insurance on the next item in the general form on which there is a loss. This plan to be followed until the whole loss is paid or the compound insurance is exhausted." (Daniels, p. 23.)

Contribution according to the order of amount of loss on the various items: "The compound insurance contributes from its full amount with the specific to pay the loss on the item covered by specific insurance on which there is the largest loss. The remainder of compound insurance after deducting amount of loss paid contributes with the specific insurance on the item having the second largest loss. This plan to be followed until the whole loss is paid or the compound insurance is exhausted." (Daniels, p. 25.)

Contribution according to the respective losses on the various items: "The principle governing all apportionments of non-concurrent policies is that general and specific insurance must be regarded as coinsurances; and general insurance must float over and contribute to loss on all subjects under its protection, in the proportions of the respective losses thereon, until the assured is indemnified, or the policy exhausted." (Daniels, p. 53.)

CHAPTER XI

PROVISIONS WHICH APPLY AFTER A LOSS HAS OCCURRED

Twofold Classification of Provisions in this Respect.

—The provisions of the fire insurance policy fall into two general classes, separated by the fact of the loss. While all provisions of the policy are to be considered as binding upon the parties to the contract, they are not, for purposes of legal interpretation, treated as equally important. In fact, nearly one-fourth of the standard fire policy consists of provisions which concern matters that are required to be done by the insured after the main fact—a loss—has taken place. In the main the courts have regarded these provisions more leniently than those which concern matters required to be done before a loss has occurred. Where doubt as to the meaning exists, the provisions are usually construed favorably to the insured, and the courts are also more easily satisfied as to the existence of a waiver. The provisions which apply after a loss has taken place may be grouped under three distinct heads, viz.: (1) those defining “notice of loss” and “proof of loss”; (2) those providing for the exhibition of records and the examination of the insured; and (3) those relating to the appraisal of the loss in case of disagreement.

Notice of Loss and Proofs of Loss.—The provisions of the standard policy relating to the giving of notice of the loss and the furnishing of the proof are the following:

The insured shall give immediate notice, in writing, to this company, of any loss or damage, protect the property

from further damage, forthwith separate the damaged and undamaged personal property, put it in the best possible order, furnish a complete inventory of the destroyed, damaged and undamaged property, stating the quantity and cost of each article and the amount claimed thereon; and, the insured shall, within sixty days after the fire, unless such time is extended in writing by this Company, render to this Company a proof of loss, signed and sworn to by the insured, stating the knowledge and belief of the insured as to the following: the time and origin of the fire, the interest of the insured and of all others in the property, the cash value of each item thereof and the amount of loss or damage thereto, all incumbrances thereon, all other contracts of insurance, whether valid or not, covering any of said property, any changes in the title, use, occupation, location, possession, or exposures of said property since the issuing of this policy, by whom and for what purpose any building herein described and the several parts thereof were occupied at the time of fire; and shall furnish a copy of all the descriptions and schedules in all policies and if required, verified plans and specifications of any building, fixtures or machinery destroyed or damaged.

Almost without exception, it is a requirement of insurance policies that, when a loss occurs, the insured shall give "immediate" notice in writing. Some policies specify a definite time within which notice must be given, as five days or ten days, and in such cases, if the insured neglects to comply with the terms of the condition, he will be doing so at his peril. The courts have recognized the reasonableness of requiring the insured to give "immediate" notice of a loss to the insurer. Prompt notice enables the company to take effective measures toward lessening the loss by properly protecting against further injury such merchandise or other property as may have been partly destroyed or left exposed. Immediate notice

of the loss will also enable the company to learn the essential facts which surround the origin of the fire, thus preventing the removal or concealment of evidence which would tend to show fraud.

The expression "immediate notice of loss," however, has been given a reasonable construction by the courts. In many cases where notice of loss could not be furnished at once, owing to good reasons, the courts have protected the insured. Thus, in the case of *Kentzler vs. American Mutual Accident Association* (88 Wis., 589), the court said: "A contract should not be construed so as to forfeit or render nugatory the rights of one of the parties to it, unless the language employed imperatively requires such construction. In other words, an interpretation which gives effect is preferred to one which makes void. 'Immediately' cannot be given the meaning of instantly, but to make good the deeds and interests of parties, it shall be construed 'such convenient time as is reasonably requisite for doing the thing.'" A great many other cases have been rendered to the same effect, it being held in some instances that thirty days' delay was not too long because of a good excuse, whereas in other cases a delay of six or seven days was regarded as too long because no good reason for the delay could be offered.

Also with respect to the furnishing of proofs of loss the courts have upheld the provisions of the policy, where they could easily be complied with; but where this could not be done, have refused to construe the same strictly. Proofs of loss are necessary to enable the company to determine the extent of the loss, and to ascertain whether the insured complied with the terms of the policy. Yet there are many circumstances which the courts have accepted as sufficient to excuse the policyholder from submitting the proofs of loss in the form or within the time required by the policy. Nor do the courts regard proofs

of loss, although sworn to, as conclusive against the insured. If the insured is acting in good faith, and desires to show that the real value of the property destroyed exceeds the amount stated in the proofs, he may recover upon the higher valuation (see *Lebanon Mutual Insurance Co. vs. Kepler*, 106 Pa., 28).

Exhibition of Property and Records and Examination of the Property Owner.—With reference to this feature the standard policy contains the following provision:

The insured, as often as may be reasonably required, shall exhibit to any person designated by this Company all that remains of any property herein described, and submit to examinations under oath by any person named by this Company, and subscribe the same; and, as often as may be reasonably required, shall produce for examination all books of account, bills, invoices, and other vouchers, or certified copies thereof, if originals be lost, at such reasonable time and place as may be designated by this Company or its representative, and shall permit extracts and copies thereof to be made.

In this connection it only remains to be said that the provision has been upheld by the courts, and that the examination must be made at the place of the fire, unless the parties by common agreement choose some other place. Here again impossibilities are not required by the law; instead the insured is obliged to make every reasonable effort to comply. To give better effect to this provision, clauses are often endorsed on the policy with a view to protecting books of account and other records against loss.

Appraisal Clause of the Standard Fire Policy.—In the settlement of losses it frequently occurs that the insurer and insured cannot agree as to the amount that should be paid. The insurance company naturally wishes to reduce its loss as much as possible and the insured, on the

other hand, is apt to claim an excessive sum. As middle-man between these two parties, the adjuster of losses will strive to effect a fair and mutually satisfactory settlement. Yet, owing to differences of opinion as to the value of buildings or merchandise, or to the absence of inventories, invoices, and other records, cases extremely difficult for settlement often arise.

To make possible the speedy solution of such cases, and to avoid unnecessary litigation, it is desirable that every fire insurance policy should provide in advance against such contingencies by setting forth a definite line of procedure. Policies of every state contain some form of "appraisal clause," and in all cases provision is made for the choice of three appraisers, one by the insured, one by the insurer, and the third by these two or by some court or state official. In the New York standard policy the following method of appraisal is provided:

In case the insured and this Company shall fail to agree as to the amount of loss or damage, each shall, on the written demand of either, select a competent and disinterested appraiser. The appraisers shall first select a competent and disinterested umpire; and failing for fifteen days to agree upon such umpire then, on request of the insured or this Company, such umpire shall be selected by a judge of a court of record in the state in which the insured property is located. The appraisers shall then appraise the loss and damage stating separately sound value and loss or damage to each item; and failing to agree, shall submit their differences only, to the umpire. An award in writing, so itemized, of any two when filed with this Company shall determine the amount of sound value and loss or damage. Each appraiser shall be paid by the party selecting him and the expenses of appraisal and umpire shall be paid by the parties equally.

It will be observed that the appraisers provided for in the aforementioned clause shall be "competent and dis-

interested." "By competent," according to Barbour,¹ "is meant one who has sufficient knowledge concerning the kind of property involved to determine values and assume damages thereto." "By disinterested," according to the same authority, "is meant one who has no pecuniary interest in the loss, is not related to any interested party, and has no connection that would tend to influence his award." (For copy of form of appraisal agreement, see p. 155.)

It will also be observed that, while both parties agree to submit to appraisal on demand of either, the insurance company is not subjected to any penalty, in case of refusal, other than to be sued at law. The insured, on the contrary, in case of refusal, is confronted with the further policy provision: "No suit or action on this policy, for the recovery of any claim, shall be sustainable in any court of law or equity, unless all the requirements of this policy shall have been complied with, nor unless commenced within twelve months next after the fire." The insured, apparently, must thus submit to appraisal according to the policy although he may afterwards, if he so desires, sue in court. Almost invariably, however, the courts have sustained appraisals, unless it can be shown that the appraisers, or the umpire, in making the award, were unduly influenced or were biased or incompetent.

In interpreting the appraisal clause it should be borne in mind that the award of the appraisers is regarded as final and binding, unless it can be shown that their action involves fraud, misconduct or incompetency. This is true even though the board of appraisers have not found the actual cash value of the property. The presumption is that the arbitrators must act in good faith, and while doing so errors of judgment will not invalidate the award.

¹ Robert P. Barbour: "Agency Key to Fire Insurance," p. 73.

FORM OF APPRAISAL AGREEMENT

IT IS HEREBY stipulated and agreed by and between... *me*...

... *you* ...
of the first part, and...

Insurance Company of... *and out*...

Insurance Company of... *Princeton*...

each acting for itself and not as agent for the other, and each as party of the second part, that...

...designated by the parties of the first part, and... designated by the parties of second part, shall ascertain, pursuant to the terms and conditions of the policies of insurance issued by said companies to the party of the first part, the sound actual cash value of the property of said party of the first part, on the 1st day of... June, 1922, which is more particularly described in the policies as

(Attach copy of Form)

as well as the actual direct loss or damage caused thereto by a fire which occurred on that day; that the said two appraisers shall first select a competent and disinterested person who shall act as umpire, and the said two appraisers together shall then estimate and appraise the loss, stating separately sound value and damage, and failing to agree shall submit their differences to the said umpire; and the award, in writing, of any two shall determine the amount of such loss. Such loss or damage shall be ascertained or estimated according to the actual cash value of said property at the time of the occurrence of said fire, with proper deduction for depreciation however caused, and shall in no event exceed what it would then cost the insured to repair or replace the same with material of like kind and quality, but such appraisalment does not in any respect waive any of the provisions or conditions of said policies of insurance, or any forfeiture thereof, or the proof of such loss and damage required by the policies of insurance thereon.

New York, June 10, 1922.

... (Name of Insured) ...

by...

Insurance Company...

by...

Special Agent...

Insurance Company...

by...

State Agent...

It is true, however, that the appraisers should limit their inquiry to the subjects submitted to them, and the award will not be sustained in case matters are considered which were not referred to them. As long as they confine themselves to the subject-matter referred to them and act in good faith, they may decide questions of law as well as fact; indeed, they constitute a sort of court that has been created by the parties to the contract to settle their disagreement.

It should here be noted that this clause is given full force in all states except one. The supreme court of Pennsylvania has thus far considered the appraisal clause as revokable at will by either party. The general rule in this country is that either party to the contract may insist on arbitration. In Pennsylvania, however, this is not the case. As Justice Sharwood stated in his opinion, given in the case of *Mentz vs. The Armenia Fire Insurance Co.* (79 Pa., 478): "There can be no doubt that if this case stood upon a general arbitration clause in the policy alone, it would fall within the principle settled by this court, conformably to all the previous English authorities, that it is not in the power of the parties to a contract to oust the courts of their jurisdiction. The cases in which the certificate or approbation of any particular person—as the engineer of a railroad company—to the amount of a claim is made a condition precedent to an action, rest upon entirely different principles. He is not created a judge or arbitrator of law and facts, but simply an appraiser of work done. That is irrevocable. That which is before us, is a mere agreement to refer to arbitrators to be chosen at a future time."

"Such an agreement, like any other agreement of reference, is revocable, though the party may subject himself to an action of damages for the revocation. It is not in the power of the parties thus to oust the courts of their

general jurisdiction, any more than they have to add to a personal covenant, that they are not to be responsible for a breach of it."

Time of Loss Payment and Subrogation.—These subjects are covered by two separate policy provisions. One stipulates that the company will pay the claim within sixty days following the receipt of proof as provided in the policy and the ascertainment of said loss by mutual agreement in writing or by appraisal. The other provides that the company, following payment of a loss, shall to that extent be entitled to subrogation from the insured by way of assignment of all right of recovery against any party. The two clauses read as follows:

1. The amount of loss or damage for which this Company may be liable shall be payable sixty days after proof of loss, as herein provided, is received by this Company and ascertainment of the loss or damage is made either by agreement between the insured and this Company expressed in writing or by the filing with this Company of an award as herein provided.

2. This Company may require from the insured an assignment of all right of recovery against any party for loss or damage to the extent that payment therefor is made by this Company.

CHAPTER XII

COINSURANCE

Meaning of Coinsurance.—Under the so-called “coinsurance clause” (also referred to as the “average clause,” the “reduced rate average clause,” and the “percentage value clause”),¹ the property owner has any loss paid only in the proportion that the amount of insurance he takes bears to the amount of insurance that the company requires him to carry. The insured is free to buy as little or as much insurance as he deems necessary, but whatever the amount may be, it is arranged that he shall recover losses from the company only in the proportion that he is willing to insure his property and pay his just share of premiums.

¹ (1) The several clauses referred to present but little variation in the wording, and usually read as follows:

COINSURANCE CLAUSE

“It is hereby agreed that the assured shall maintain insurance during the life of this policy upon the property hereby insured to the extent of at least per cent of the actual cash value at the time of the fire; and that failing so to do, the assured shall to the extent of such deficit bear his proportion of any loss.”

AVERAGE CLAUSE

“This Company shall not be liable for a greater proportion of any loss or damage to the property described herein than the sum hereby insured bears to per cent of the actual cash value of such property at the time such loss shall happen.”

REDUCED RATE AVERAGE CLAUSE

“In consideration of the reduced rate at which this policy is written, it is expressly stipulated that, in event of loss, this Company shall be liable for no greater proportion thereof than the amount hereby insured bears to per cent of the actual cash value

In some instances a further provision, the so-called "5 per cent waiver clause," is used in connection with the coinsurance clause. It usually reads to the following effect: "In the event that the aggregate claim for any loss is less than (\$10,000) ten thousand dollars (provided, however, such amount does not exceed five per cent (5%) of the total amount of insurance upon the property described herein, and in force at the time such loss occurs) no special inventory or appraisal of the undamaged property shall be required. If this policy be divided into two or more items, the foregoing conditions shall apply to each item separately." This clause, it should be noted, merely waives the special inventory or appraisal of the undamaged property, and in no sense waives the operation of the coinsurance clause itself. When very large values are covered under an insurance policy, the companies recognize the hardship to which the insured would be put, in the event of small losses, if required in all cases to furnish an inventory of the undamaged and damaged property.

The Application of Coinsurance Illustrated.—It is apparent from the wording of the coinsurance clause that the company designates the amount of insurance, expressed in the form of a percentage of the value of the property, which it desires the insured to carry. Thus under a "full coinsurance clause," or for 100 per cent, the com-

of the property described herein at the time when such loss shall happen, nor for more than the proportion which this policy bears to the total insurance thereon."

PERCENTAGE VALUE CLAUSE

"If at the time of fire the whole amount of insurance on the property covered by this policy shall be less than per cent of the actual cash value thereof, this Company shall in case of loss or damage be liable for only such portion of such loss or damage as the amount insured by this policy shall bear to the said per cent of the actual cash value of such property."

pany agrees to indemnify any loss only in the proportion that the insurance actually taken bears to the full value (100%) of the property. In most instances, however, the companies require the owner to insure his property to only 80 per cent of its value. The percentage required is intended to represent that proportion of the insured property which is subject to destruction by fire, and will, therefore, depend upon the character of the property under consideration. If the 80 per cent coinsurance clause is used, the company considers itself liable for only that portion of any loss resulting from fire which is represented by the proportion that the actual insurance purchased bears to the required 80 per cent. Thus if we assume the value of a building to be \$20,000, then, under the 80 per cent coinsurance clause, the company will require the insured to take a policy for at least \$16,000. If this is done the company agrees to pay in full any loss, not exceeding the face value of the policy. Suppose, however, that the insured decides to take only \$8,000 of insurance, or one-half of the required amount, and that a loss of \$4,000 takes place. Under these circumstances, the coinsurance clause prevents the insured from collecting his claim in full, as he otherwise would, by providing that this \$4,000 loss is to be paid only in the proportion that the insurance actually carried (\$8,000) bears to the 80 per cent insurance required (\$16,000), i.e., one-half of \$4,000, or \$2,000. Since the insured elected to take only 50 per cent insurance, he became, as far as any losses are concerned, coinsurer for the other half. If \$10,000 of insurance had been taken, instead of \$8,000, the \$4,000 loss would have been paid in the proportion that \$10,000 bears to \$16,000, i.e., five-eighths of \$4,000, or \$2,500. If, on the other hand, a 100 per cent, or full coinsurance clause, had been used, and only \$8,000 of insurance taken, the property owner would have had his loss paid in the proportion that \$8,000 bears to \$20,000

(the full value of the property) i.e., to the extent of two-fifths of \$4,000, or \$1,600.

Assuming the use of an 80 per cent coinsurance clause, it is important to bear in mind the following six points:

(1) If the insured fails to take insurance to at least 80 per cent of the value of the property, he is regarded in effect as a coinsurer (a self-insurer) for the balance, hence the name "coinsurance." If \$8,000 of insurance is required, because that amount constitutes 80 per cent of the value of the property, and only \$4,000 is taken, the insured is regarded as having two policies on his property, one with the company for \$4,000 and another for an equal amount in his own self-insurance fund. Fire policies provide that "the Company shall not be liable for a greater proportion of any loss or damage than the amount hereby insured shall bear to the whole insurance covering the property, whether valid or not and whether collectible or not." Accordingly, the company pays a loss, let us say of \$2,000, in the proportion that its \$4,000 policy bears to the total insurance of \$8,000 (its own \$4,000 policy plus the insured's self-insurance of \$4,000), or to the extent of one-half, or \$1,000.

(2) The valuation of the property to which the 80 per cent applies is the insured's valuation. The owner, if any one, should know the approximate value of his property. Much expense is avoided if the owner's value is accepted in all cases and if an investigation by the insurer is limited to those comparatively few cases, out of the total number of existing properties, where a loss actually occurs. The value of property, moreover, changes from time to time, and the insured should, therefore, adjust his insurance to meet the requirements of the coinsurance clause. The importance of this factor is indicated by the fact that during recent years insurance companies publicly advertised the enormous appreciation of property values and cautioned

policyholders to increase their insurance in conformity with the coinsurance requirement.

(3) The 80 per cent coinsurance clause does not mean that the company will pay only 80 per cent of any loss, or that the insured is prohibited from taking insurance beyond 80 per cent of the value. The owner is free to insure the property to 100 per cent of its value if he so desires, and will then have any loss paid in full. If the insured is careful to have insurance amounting to 80 per cent or over, he is entitled to collect just as though the policy had no coinsurance clause attached to it.

(4) The clause becomes inoperative if the loss is equal to or exceeds the stipulated percentage of value. Thus let us assume that the insurance required (80%) is \$8,000, the insurance taken \$2,000, and the loss \$8,000. In that event the company will pay the \$8,000 loss in the proportion that \$2,000 bears to \$8,000, or to the extent of \$2,000, the full face value of the policy.

(5) All of the required insurance need not be taken in one company. The insured is free to obtain concurrent insurance in different companies to an amount sufficient to meet the percentage of value requirement. In fact, the attachment of a coinsurance clause means that the insured has permission to obtain other insurance necessary to bring the total to the amount prescribed by the clause.

(6) Should a policy with a coinsurance endorsement insure more than one item, it is highly desirable to make the clause apply to each item separately. The wording incorporated in the clause to meet such a situation usually reads: "If this policy be divided into two or more items, the foregoing conditions shall apply to each item separately."

Reasons Justifying Coinsurance.—*Justice between property owners.*—The use of coinsurance is absolutely essen-

tial to secure justice between different property owners, and to enable the company to collect premiums from all, commensurate with the risk assumed. It is a well-known fact that in cities with good fire protection comparatively few fire losses are total, and that the overwhelming majority of fires result in comparatively small or nominal losses. Thoroughly appreciating this fact, many owners would be willing, in the absence of coinsurance, to run the chance of carrying a small amount of insurance, thus paying a proportionately small premium, with the hope that their policies will be large enough to cover their partial losses. The total fire waste, however, is not in the least diminished, and the insurance companies must collect the same aggregate premium income to meet their claims. The result is that those property owners who do not wish, or because of credit obligations cannot afford, to gamble with chance, and must insure their property to nearly its full value, are obliged to pay a much larger premium when compared with the losses they suffer during a given period of time, since they help to pay the many partial losses of those numerous owners who shirk the payment of their just portion of the fire tax. Let us assume that A and B each own a building valued at \$10,000 and that the premium rate is 1 per cent. Let us also assume that A insures his property to the extent of \$8,000, but that B, knowing that the great majority of losses are partial and relatively small, decides to take chances with a \$2,000 policy. At a rate of 1 per cent A pays a premium of \$80, and B only \$20. Now, let us assume that both owners suffer a loss of \$2,000. In case there were no coinsurance both would receive their \$2,000, although A paid four times as large a premium as B.

But it might be argued that the difference between \$80 and \$20 represents a just payment for A's additional protection of \$6,000, over and above B's policy of \$2,000.

This contention, however, is a fallacy. The fact is that the aggregate loss from the numerous small fires constitutes by far the largest portion of the total fire waste. Hence, those who cannot afford to run the risk of taking partial insurance only would, in the absence of coinsurance, pay premiums out of all proportion to the benefits received.

Thus, let us assume 50,000 properties, each valued at \$10,000, each insured to its full value, and the companies paying on the basis of losses (as regards number and average size) as indicated in the following table:¹

ASSUMED FIRE LOSS EXPENSE ON 50,000 PROPERTIES

Size of loss. Ratio of loss to value	Number of losses occurring	Average size of loss
Between 0 and 10%.....	751	5%
" 10 " 20%.....	107	15%
" 20 " 30%.....	47	25%
" 30 " 40%.....	30	35%
" 40 " 50%.....	20	45%
" 50 " 60%.....	16	55%
" 60 " 70%.....	12	65%
" 70 " 80%.....	9	75%
" 80 " 90%.....	5	85%
" 90 " 100%.....	3	95%

An examination of the above table indicates a total fire loss of \$1,153,000, all of which must be paid by the companies since the properties are insured to their full value. Disregarding any addition for expenses, the cost

¹This and the following tables were prepared by Mr. David McCahan. In their preparation he used as a basis for his computation the fire loss experience reported by Mr. A. W. Whitney as taken from the statistics of the San Francisco Fire Patrol. The tables are merely intended to illustrate the argument.

Amount of loss companies would be liable to pay

751	losses at an average of \$ 500	\$ 375,500
107	" " "	1500
47	" " "	2500
30	" " "	3500
20	" " "	4500
16	" " "	5500
12	" " "	6500
9	" " "	7500
5	" " "	8500
3	" " "	9500
<hr/>		
1000		\$1,153,000

to each of the 50,000 policyholders is \$23.06. If, however, each property be insured for only 10 per cent (\$1,000), instead of 100 per cent, the liability of the companies for losses on the basis of the preceding assumptions will be as follows:

LIABILITY OF COMPANIES WHEN INSURANCE IS ONLY 10 PER CENT OF VALUE.

751	losses at an average of \$ 500	\$375,500
107	(face of policy) \$1000	107,000
47		47,000
30		30,000
20	(face of policy in all	20,000
16	cases)	16,000
12		12,000
9		9,000
5		5,000
3		3,000
<hr/>		
1000		\$624,500

With 100 per cent insurance, the aggregate loss on the 50,000 properties amounted to \$1,153,000 and the cost per policyholder was \$23.06. With only 10 per cent of the value insured, the total loss to the companies amounted

to \$624,500, or considerably more than one-half of the loss incurred under 100 per cent insurance. Under 10 per cent insurance the cost to each of the 50,000 policyholders is \$12.49. It thus becomes clear that insurance companies cannot compute their premiums on the basis of 100 per cent insurance, or any other percentage, and give to all policyholders the same rate, with a promise to pay all losses in full, irrespective of the amount of insurance carried. Under such a plan, the owner insuring to the extent of 100 per cent would be asked to pay \$23.06, and the one insuring on the identical property to the extent of 10 per cent only \$2.31. Yet we have seen that when all the properties are insured to the extent of 10 per cent of their value, the companies must collect \$12.49 from each policyholder to meet the losses, an amount equal to nearly five and one-half times \$2.31. In other words, without coinsurance those insuring to only 10 per cent under our illustration would be paying only 18 per cent (\$2.31 as compared with \$12.49) of what is necessary to pay for their protection.

Rates of premium similar to tax rates.—It may be argued that some properties are of such excellent construction, or are so well protected, that only small partial losses need be expected and that the owner should therefore be entitled to reduce his insurance accordingly. This contention, however, is also fallacious, assuming that the property is subject to destruction to the percentage of value stipulated in the coinsurance clause.² Rates of premium, as will be explained in the chapter on rate mak-

²In the case of so-called fireproof buildings companies recognize the fact that only a limited percentage, like 15 or 20 per cent of the value, is susceptible to destruction by fire. Accordingly, the required amount of insurance is limited to these low percentages. Should the insured take out insurance in excess of the low percentage required, the rate charged on the basis of the 15 or 20 per cent will be reduced as the amount of insurance increases.

ing, are computed with reference to construction, fire prevention and hazard. With respect to the many types of properties, rates of premium are, as pointed out by Robert P. Barbour, "reduced proportionately with the likelihood that fire occurring will only partially destroy the property involved. Manifestly rates can be so reduced only when a *partial loss to property* will result in a proportionately *partial loss to insurance* thereon. Governed by the laws of average these rates cannot be fixed to justly and equitably distribute the burden of this fire cost unless the percentage of insurance carried to the value of property covered is about the same in each case, or else some limitation of liability for loss in the proportion that insurance bears to value, precisely as it is impossible to justly and equitably fix an average rate of city taxation unless the assessed valuation of all buildings is fixed at the same percentage of their full or market value."³

With rates reduced to a common level, i.e., having taken into account the merits of the property, it follows that an owner who is willing to pay only one-tenth of the premium required of the community in general should have his losses paid in the same proportion. Application of the coinsurance principle may be likened to the application of a government tax. The cost of fire insurance, as already noted, is a tax paid by all the property owners of the community for the purpose of indemnifying unfortunate losers. In form it resembles a general property tax, except that it is collected and disbursed by private companies instead of by the government. As the government tax, to be equitable, should be paid by the owners of property in proportion to the value of the same, so the fire insurance tax, to be equitable, should also be based

³ Robert P. Barbour: "The Agent's Key to Fire Insurance," p. 117.

upon the value of the property owned, and not according to what the insured may choose to pay. As our states and municipalities adopt a uniform method of assessment in levying their taxes with a view to preventing discrimination, so in fire insurance the same uniformity of assessment should prevail, and the same effort should be made to prevent discrimination between those who insure partially and those who insure fully. Evasion in the payment of the fire tax should be regarded as no less unjust than the evasion of government taxes.

Protection of small against large owners.—Coinsurance serves another very useful purpose in protecting small owners against the efforts of large industrial and mercantile corporations to shirk the payment of their just share of premiums. In most large mercantile and manufacturing concerns it will be found that the property is either situated in different localities, or that the contents in a given locality are stored in different compartments, each separated from the other by fire-proof walls or at least so protected that in the great majority of cases the fire can easily be confined to the compartment where it originated. Under such circumstances a total loss is hardly to be expected, and no one realizes this better than the owner. Thus, let us assume that X is the owner of three plants, situated in three different localities, and each worth \$100,000. If these three plants are located so far from each other that from a fire insurance standpoint none is affected by the other, it is apparent that, if permitted, the owner could fully protect himself by taking out a blanket policy of \$100,000, covering all three items. Having taken insurance equal to the value of the most valuable item, his loss could not exceed this amount, except under the most unusual event of a fire occurring in at least two properties at the same time. Now let us assume that Y, a competitor of X, owns a single plant

valued at \$100,000. It is clear that Y would be obliged to take \$100,000 of insurance if full protection is desired. If rates are the same, and if all losses are to be paid in full, irrespective of the amount of insurance taken, it follows that X could receive three times the amount of protection for the same premium that his smaller competitor, Y, would be obliged to pay on his single plant. To prevent large owners from securing full protection on numerous items of property by simply taking out a policy equal in amount to the value of the most valuable item, insurance companies require that blanket policies be taken "with 80 per cent coinsurance," i.e., the insured agrees to keep all his property insured for 80 per cent of its value.

Anti-Coinsurance Laws.—The fairness of coinsurance as a means of establishing equitable rates is so well recognized that in many countries, like France, Italy, Spain, Belgium, Japan, etc., the practice is made compulsory by law. The principle has also been used in marine insurance from very early times. In the United States, however, it was not until about 1890 that a serious attempt was made to apply coinsurance generally to fire policies. Even to-day the vital importance and inherent justice of the practice are not appreciated in many sections of the country and a number of states still have so-called "anti-coinsurance laws" upon their statute books. Legislation of this sort shows a woeful ignorance of the true relation of fire insurance to the business community. The law of Texas may be cited as a typical illustration of this type of legislation. It reads: "No company subject to the provisions of this chapter shall issue any policy or contract of insurance covering property, real or personal, situated in this State which shall contain any clause or provision requiring the assured to take out and maintain a larger amount of insurance than that expressed in such policy, nor in any way providing

that the assured will be liable as a coinsurer with the company issuing the policy for any part of the loss or damage which may be caused by fire to the property described in the policy, and any such clause or provision shall be null and void and of no effect, whether written with or without the consent of the assured; and any company issuing a policy with such provision or provisions therein shall nevertheless be liable to the assured for the full amount of the damage and loss sustained by the property holder, not exceeding the face of the policy, notwithstanding such provision or provisions." (Acts 33d Leg., Chap. 104, Sec. 1).

Graded Rate Systems.—It may be asked: Why should a property owner be compelled to take out a prescribed amount of insurance, when he insists on having less? Considering that he does an injustice to other owners by taking out too little insurance, is there not a way of giving the insured what he wishes, and at the same time make him contribute an amount in premiums which will correctly compensate for the injustice? The answer is that the effect of coinsurance may be realized by grading the rates according to the amount of insurance carried, and then paying all losses in full. The other plan, it will be recalled, involves keeping the rate the same no matter what the amount of insurance, and then paying all losses only in the proportion that the insurance taken out bears to the required 80 per cent. Mathematically, the two plans can be shown to equal each other. The plan of grading rates, according to the amount of insurance, would seem to have the advantage of eliminating the compulsory feature which has aroused so much antagonism from owners and legislators. There are many who argue that when buying any other commodity they are not told that they must purchase a certain quantity. They contend that there is no reason why buyers of

insurance should not be free to purchase the amount of insurance they desire, and have all losses paid in full up to the face of the policy, provided they are willing to pay the price.

In our previous illustration of 50,000 houses valued at \$10,000 each and insured for only 10 per cent without the application of coinsurance, it was found that the companies would have to collect \$12.49 from each policyholder in order to pay losses. If similar calculations are made for other percentages of insurance, the cost per policyholder and the rate per \$100 of insurance would be as follows:⁴

COST TO EACH OF THE 50,000 POLICYHOLDERS

						The rate per \$100 of insurance
\$12.49 if insured to \$1,000 or 10% of value..						\$1.249
16.40	"	"	2,000	20%	" ..	.820
18.77	"	"	3,000	30%	" ..	.626
20.37	"	"	4,000	40%	" ..	.509
21.47	"	"	5,000	50%	" ..	.429
22.21	"	"	6,000	60%	" ..	.370
22.67	"	"	7,000	70%	" ..	.324
22.92	"	"	8,000	80%	" ..	.287
23.03	"	"	9,000	90%	" ..	.256
23.06	"	"	10,000	100%	" ..	.321

Assuming that 80 per cent is taken as the proper basis, the question arises: What percentage of the 80 per cent rate should be taken for any other amount of insurance (i.e., for any other coinsurance clause) which the insured may choose to take? This is indicated by the following table:

⁴This and the following table were computed by Mr. David McCahan.

PERCENTAGE OF THE 80 PER CENT RATE APPLICABLE TO OTHER
PERCENTAGES OF INSURANCE

If 10% is carried,	435%
20%	289%
30%	218%
40%	177%
50%	149%
60%	129%
70%	113%
80%	100%
90%	89%
100%	80%

An examination of the foregoing table shows that the two systems—the graded rate system increasing rates as the insurance decreases and paying losses in full, and the coinsurance clause method keeping rates the same and reducing the claim as the insurance decreases—may be equivalent mathematically. If, under the graded rate system, the owner desires insurance to only 10 per cent of the value of his property, with all losses paid in full until his policy is exhausted, he may be allowed to do so upon the payment of a rate equal to 435 per cent ($1.249 \div .287$) of the rate arrived at for his building on an 80 per cent basis. If he desires 20 per cent insurance his rate will be equal to 289 per cent ($.82 \div .287$) of the rate on the 80 per cent basis, and if 50 per cent insurance is desired the rate will be 149 per cent ($.429 \div .287$) of the 80 per cent rate.

But while the two methods may be made equivalent mathematically, the graded rate system is used to only a limited extent. It has the advantages, it is true, of giving the insured the amount of insurance desired, and of enabling the companies to secure justice between property owners in states that prohibit the use of the coinsurance clause. The coinsurance clause, however, has been a practical success, and has served as an incentive

to policyholders to insure their property to the required extent. It has also the advantage of being the only practical method thus far available. Probably the greatest deterrent to the adoption of a graded rate plan has been the lack of properly classified records and the consequent inability thus far to give the subject sufficiently exact analytical treatment.

Special Coinsurance Clauses.—Two special clauses deserve mention, namely, the “floating coinsurance clause” and the “percentage coinsurance and limitation clause.” The first stipulates “that in case the property aforesaid in all the buildings, places or limits included in this insurance shall, at the breaking out of any fire or fires, be collectively of greater value than the sum insured, then this Company shall pay and make good such a portion only of the loss or damage as the sum insured shall bear to the whole value of the property aforesaid, at the time when such fire or fires shall first happen.” It also provides that if any of the property in any place, within the limits of the insurance, should be covered by other insurance, the policy shall cover only “as far as relates to any excess of value beyond the amount of such specific insurance or insurances, and shall not be liable for any loss, unless the amount of such loss shall exceed the amount of such specific insurance or insurances, which said excess only is declared to be under the protection of this policy and subject to average, as aforesaid.”

The “percentage coinsurance and limitation clause” had its origin in an effort to eliminate moral hazard. By its terms the insured is obliged to insure his property to a stated percentage of its value, but at the same time must bear a stipulated percentage of any loss himself. The following is one form of the clause:

If at the time of fire the whole amount of insurance on the property covered by this policy shall be less than (75)

per cent of the actual cash value thereof, this Company shall, in case of loss or damage, be liable for such portion only of the loss or damage as the amount insured by this policy shall bear to the said (75) per cent of the actual cash value of such property; *provided*, that in case the whole insurance shall exceed (75) per cent of the actual cash value of the property covered by this policy, this Company shall not be liable to pay more than its pro rata share of said (75) per cent of the actual cash value of such property; and should the whole insurance at the time of fire exceed the said per cent a pro rata return of premium on such excess of insurance from the time of the fire to the expiration of this policy shall be made on surrender of the policy.

Other Leading Clauses Distributing Loss or Limiting the Insurer's Liability.—*Pro rata clause.*—It often happens that a policy covers various items of property. In that event a so-called “pro rata clause” may be endorsed on the policy, whereby the entire policy is made to cover each item in the proportion that the entire insurance under the policy bears to the value of all the items. The clause usually reads: “This policy covers pro rata of each of the above amounts aggregating \$.....”. Thus, if a \$30,000 policy is made to apply pro rata over three items valued respectively at \$30,000, \$20,000 and \$10,000, the extent to which the insurance covers each of the items is indicated by the following:

Value		Coverage	
1st item.....	\$30,000	Policy covers....	\$15,000
2d item.....	20,000	Policy covers....	10,000
3d item.....	10,000	Policy covers....	5,000
<hr/>		<hr/>	
Total.....	\$60,000	Policy covers....	\$30,000

Pro rata distribution clause.—One of the many wordings of this clause is: “This policy shall attach in each build-

ing or location in the proportion that the value in each bears to the value in all." The purpose of the clause is to distribute the insurance automatically over the several items in proportion to their respective values, irrespective of the fluctuations that may occur from time to time in such values. In the case of buildings, since they are subject to little fluctuation in value, there is little need for such a clause. But with respect to machinery or stocks of goods, where values shift rapidly and greatly from one location to another but remain fairly constant as regards total value, the clause fulfills a distinct service. In such cases it is difficult, if not impossible, to carry adequate specific amounts of insurance on the several locations. While comparatively easy to know the aggregate value, it is most difficult, and in many instances impracticable, to keep a record of the values at each separate location.

The distribution and 80 per cent coinsurance clauses are often used in connection with blanket policies. The company is thus fully safeguarded and the insured, if a sufficient amount of insurance has been taken, is protected against the possibility of inadvertently having insufficient protection. But the insured must be careful (1) to take insurance sufficiently large in amount to meet his full requirements in any one location, and (2) to make the insurance bear such relation to the aggregate value as to comply with any coinsurance requirement endorsed on the policy.

Two-thirds vacancy clause.—Vacancy and unoccupancy lead to an increase in the fire hazard, partly because of the greater deterioration to property when not in use, and partly because of the greater danger of fire to the property through the acts of unauthorized persons obtaining entrance to the premises. Hence, the policy may be endorsed with a clause, providing that, in lieu of the additional premium which is customarily charged for either vacancy

or unoccupancy, it is "agreed that while the premises so remain vacant under this permit the amount of insurance under this policy shall be reduced one-third; and when attached to a policy covering more than one item, the amount of insurance on each item shall be considered as having been reduced to the extent above named. This permit is given and accepted under the foregoing conditions." At other times the clause is made to read:

During such vacancy or unoccupancy **ONE-THIRD** of the amount of the insurance hereunder shall be and remain suspended and of no effect, and in case of loss this company shall not be liable to pay or make good to the insured exceeding **TWO-THIRDS** of the amount insured on said premises, nor exceeding **TWO-THIRDS** of the amount of loss or damage thereto.

Three-fourths value and three-fourths loss clauses.—In cities with good fire protection, it is the desire of companies to prevent the insured from taking out too little insurance. On the contrary, in communities where fire protection facilities are poor and where losses are apt to be total rather than partial, or in the case of properties which constitute dangerous risks, it is the desire of companies to assure themselves of the owner's interest in safeguarding the property. To accomplish this purpose, companies use the so-called "three-fourths value clause" or the "three-fourths loss clause." Thus, if a building is valued at \$10,000 at the time of the fire and is insured under an \$8,000 policy containing a "three-fourths loss clause," and the loss amounts to \$8,000, the company's liability is limited to three-fourths of \$8,000, or \$6,000. If, however, this \$8,000 policy contained a "three-fourths value clause," the company's liability would be three-fourths of \$10,000, or \$7,500. The three-fourths loss clause, it is apparent, is the most severe and will serve as a greater

incentive towards carefulness on the part of the owner than the three-fourths value clause. The following two are given as typical examples of these two clauses:

THREE-FOURTHS VALUE CLAUSE

It is a part of the consideration of this policy and the basis upon which the rate of premium is fixed, that, in the event of loss, this company shall not be liable for an amount greater than three-fourths of the actual cash value of the property covered by this policy at the time of such loss, and in case of other insurance, whether policies are concurrent or not, then for only its PRO RATA proportion of such three-fourths value.

If this policy be divided into two or more items, the foregoing conditions shall apply to each item separately.

Total insurance permitted is hereby limited to three-fourths of the actual cash value of the property hereby covered and to be concurrent herewith.

THREE-FOURTHS LOSS CLAUSE

It is understood and agreed to be a condition of this insurance, that, in the event of loss or damage under this policy, this company shall not be liable for an amount greater than three-fourths of such loss (not exceeding the sum insured) and, in the event of additional insurance permitted thereon, then this company shall not be liable for an amount greater than its proportion of three-fourths of such loss; in both events the other one-fourth to be borne by the insured.

CHAPTER XIII ✓

REINSURANCE

Definition of Reinsurance.¹—Reinsurance may be defined as the practice whereby one underwriter (the original insurer) transfers his liability under a policy, either in part or in whole, to some other underwriter (or a group of underwriters) known as the reinsurer. The contract of reinsurance is made solely between the companies, the insured possessing no right to make a claim against the reinsuring company in case of loss. From an economic standpoint, however, the insured is vitally interested in the practice. Since the reinsured company depends upon the reinsuring company for the payment of its share of any loss, it follows that property owners are vitally concerned in the financial strength of the reinsuring companies. As a matter of fact, these companies have *insured the insurance* placed by the property owner with the original company, and failure on their part to meet a loss may in turn cause the direct-writing company to fail in meeting its liability to the insured. It is, therefore, highly desirable that property owners, when placing a large policy with an underwriter, should make inquiry as to the financial standing of the reinsurers.

¹ For a detailed discussion of the reasons for, and the practices pursued in connection with, reinsurance in Marine Insurance, see S. S. Huebner: "Marine Insurance," Chapter XIV, on "Reinsurance Agreements in Marine Insurance," pp. 151-168.

Extent of Reinsurance.—The importance of reinsurance is indicated by the extent to which leading fire and marine companies resort to the practice. Thus, for the year 1918, five large American companies collected in gross fire insurance premiums \$76,215,952, after deducting returned premiums. Of this amount they ceded (reinsured) to other companies \$16,898,521, or nearly 22½ per cent. With respect to marine insurance for the same year, all of the 87 American companies transacting that type of business collected gross marine and inland premiums, after deducting returned premiums, of \$158,996,523. Of this amount \$65,882,233, or 41.5 per cent, was reinsured with other companies, both domestic and foreign. For the 40 alien companies with branch offices in the United States, the showing is almost the same. Out of a total gross marine and inland premium income of \$71,898,000 during 1918, they reinsured \$30,196,000 with other companies, or to the extent of 42.1 per cent.

Reasons for Reinsurance.—The foregoing figures cannot fail to show the importance of the subject in the field of fire and marine underwriting. In fact, the modern stability of fire and marine insurance companies, and their ability to cope with large conflagrations and marine catastrophes is due largely to their policy of limiting their lines of insurance. The need for additional reinsurance facilities is such that there has been a marked tendency towards the incorporation of insurance companies devoted purely to reinsurance, i.e., which do not participate as original underwriters at all, but confine their business solely to the acceptance of risks from other direct-writing companies. This tendency, however, has thus far been much more marked in certain foreign countries than in the United States. Briefly described, the leading reasons for and the advantages growing out of reinsurance are:

- (1) Gives companies the benefit of the greater stability

resulting from a wide spread of business. By accepting many risks and scaling down, by reinsurance, all those that are larger than the normal carrying capacity of the company justifies, certainty in business is substituted for uncertainty through the better application of the law of average. A wide distribution of comparatively small risks produces a more certain income and eliminates the element of gamble. A regular trade profit is assured with reasonable stability from year to year. Fire insurance is particularly susceptible to abnormal losses arising out of conflagrations. To avoid such situations, the companies pursue a definite policy in distributing their risks. To make the application of the law of average reasonably certain, they first of all place a limit or so-called "line" upon the amount of insurance that they will carry on a single risk. Next, a block limit is fixed, representing the amount of insurance a company will carry on all of the buildings within the block. Finally, to protect themselves against large conflagrations, they fix a "conflagration limit," representing the amount of insurance the company is willing to carry on all the properties situated within the area considered subject to sweeping fires.

(2) Enables companies to accept policies for large amounts with the knowledge that they can protect themselves against staggering losses by adjusting the risks in such a manner as to preclude the possibility of any serious inroad into their capital and surplus. To assume and retain a \$1,000,000 risk is obviously unbusinesslike, because a total loss on this single venture might more than wipe out the entire annual profit on all the other business of the company. Yet, fire insurance companies very frequently have offers which they find inconvenient, for business reasons, to decline, and are thus obliged to accept much larger amounts of insurance on a given building, or within a given area, than they care to assume. With increasing

frequency single large business concerns make shipments of such size as often to require the entire carrying capacity of a large vessel, and to economize in time and labor, there is a desire to place the insurance with one or a few large companies rather than to negotiate the business with numerous smaller underwriters distributed throughout the entire insurance market. Under these circumstances the desire is to place the insurance with the least trouble and annoyance and have the original underwriter assume the work of distributing the large risk among reinsurers. If the risk is a very large one, such distribution may be so extensive as to involve scores of companies.

A marine company, it should also be added, usually insures many merchants under so-called "open policies," covering all their shipments on any vessel or vessels during a long period of time. Such policies often result in great congestion on a single steamer because of the fact that the cargoes of different shippers, insured by the same company, may happen accidentally to be concentrated in the same place. It is impossible to estimate how many shipments on a single vessel are covered under various policies of insurance, each in itself to the limit of the company's capacity. The same thing is also true as regards concentration of property at a single compress or location on shore. It is, therefore, necessary to arrange very large automatic reinsurance covers because no single company can handle the business with safety to its resources.

(3) Makes it possible for large business transactions to be financed promptly at the banks, since the insurance collateral may be negotiated within a few hours owing to the existence of automatic reinsurance arrangements. Inability to do this would handicap greatly many lines of business, especially where competition between markets requires the prompt acceptance of orders at closely figured prices. To meet such situations it is common in various trades to have

groups of underwriters undertake jointly the insurance of very large values, each company participating to an agreed percentage.

(4) Certain exceptional uses should be mentioned, although their aggregate importance is small in comparison with the services already discussed. One of these is "arbitraging," which may be defined as the practice of clipping a profit by buying and selling the same subject in two different markets at about the same time. In insurance it may happen that an underwriter closes a contract at 2 per cent and then finds that he can reinsure all or a part of the risk at the lower rate of $1\frac{1}{2}$ per cent, the difference of one-half of one per cent being his profit. If the entire risk is reinsured and if the reinsurance for which the arbitrager remains legally the guarantor is financially sound, the original underwriter has relieved himself of all liability, and may regard the one-half of one per cent difference in rates as a clear profit.

Another form of reinsurance involves the assumption by a reinsurer of all the risks of a liquidating company. For various reasons, such as impairment of capital through unfortunate losses or inability to transact business on a sufficiently paying basis, an insurance company may wish to liquidate its affairs and retire from the field. Many of its policies, however, are untermiated. These contracts the retiring company may wish to protect, and yet its desire is to liquidate before their maturity. If the retiring company possesses sufficient funds to pay the necessary premiums, it may find some other underwriter willing to take over its entire business by way of reinsurance. Consequently the policyholders are protected, the company is enabled to retire, and the liquidation is speedily and amicably effected.

Conditions Required in Effecting Reinsurance.—While some fire policies are silent as to the subject of reinsurance,

others contain some such provision as "liability for reinsurance shall be as specifically agreed hereon." But while the standard fire policy leaves the arrangement of conditions governing reinsurance to the companies interested,² certain fundamental conditions should invariably underlie the arrangement. In the first place, the presumption is that the reinsured company is acting in good faith toward the reinsurer. Its motive in effecting reinsurance should be to reduce a line of insurance which it regards as excessive. Reinsurance is not justified if the reinsured company, without acquainting the reinsuring company with all the facts, seeks to unload its liability because of its knowledge that the rate charged the insured is too low, or that the risk is otherwise undesirable. Reinsurance should especially be avoided where a moral hazard is found to be involved. Precaution should also be taken to prevent the reinsuring company from separating the risk, i.e., retaining the best portion, and through reinsurance relieving itself of the most hazardous portion at the rate charged for the combined risk. It is for such reasons that reinsurance agreements often provide that the reinsuring company should not have more of the risk ceded to it than is retained by the reinsured company.

The importance of the foregoing considerations is generally recognized, and reinsurance agreements almost invariably contain conditions which seek to protect the reinsuring company from such contingencies. While the wording of agreements for reinsurance varies considerably, the following agreement is representative in the fire insurance business:

² Reinsurance contracts are often very complex and detailed and cover a multitude of subjects. For copies of reinsurance agreements in Marine Insurance, see Appendices XII and XIII in S. S. Huebner: "Marine Insurance," pp. 224-252.

REINSURANCE FORM

(Approved by the National Board of Fire Underwriters)

"This policy is issued as reinsurance to apply to Policy No. of the Insurance Company, and is subject to the same risks, privileges, conditions and endorsements (except changes of location), assignments, changes of interest or of rate, valuations and modes of settlement, as are or may be assumed or adopted by the said company.

The amount payable under this policy shall bear the same ratio to the amount payable by the reinsured company under any and all policies upon the property specified and contained within the limits described herein, that the amount of this reinsurance in force at the time of loss shall bear to the total amount insured by the reinsured company upon such property in force at the time of such loss, and shall be paid at the same time and in the same manner as payment shall be made by said reinsured company.

Other reinsurance is permitted without notice until required."

(If it is desired to attach a retainer clause to the foregoing reinsurance clause, the following may be mentioned as having been approved by the National Board of Fire Underwriters.)

FORM OF RETAINER CLAUSE

"The reinsured company shall retain at its own risk, on the identical property covered at the time of any loss, by this policy, over and above all its reinsurance thereon, an amount equal to the amount of this policy upon such property, and, failing so to do, the amount which would otherwise be payable under this policy by reason of said loss shall be proportionately reduced."

An examination of the aforementioned form shows that reinsurance is governed by three customary conditions with

the possible addition of a fourth. (1) The reinsurance is subject to "original conditions," i.e., "the same risks, privileges, conditions and endorsements (except changes of location), assignments, changes of interest or of rate, valuations and modes of settlement, as are or may be assumed or adopted by the said company." (2) The liability of the reinsurer for loss payment is limited to that proportion of the liability of the reinsured company that the amount of the reinsurance bears to the total insurance carried by the original underwriter on the property under consideration. (3) The reinsuring company permits the reinsured underwriter to effect other reinsurance without notice until such time as the permission is revoked. (4) If the retainer clause is attached, the reinsured company agrees that it will retain as much of the risk, over and above all its reinsurance thereon, as it has ceded to the reinsuring company. In case of failure to do so, it is agreed that the amount, otherwise payable on the reinsurance policy, shall be reduced proportionately.

Types of Reinsurance Agreements.—*Agreements covering specific risks.*—Large companies find it necessary to place such reinsurance on individual risks almost daily. The contracts, entered into with individual companies as distinguished from a group of companies acting collectively, may vary considerably in their terms. But in the main they follow the form already discussed, which, as stated, is attached to the reinsured policy and also made a part of the reinsuring policy.

Reinsurance "clearing houses" or "exchanges."—In such organizations all the subscribing member companies agree to observe the provisions of a detailed reinsurance agreement. They are all represented by a manager, who is the attorney or agent "of the subscriber of each identical instrument with adequate power to record cessions of reinsurance for such subscribers and who may otherwise act

for them in that connection as hereinafter provided." The agreements are usually very detailed, and refer among other things to the government of the organization by committees, powers of the manager, qualifications necessary for membership, territory to be covered, prohibitions that must be observed by the members, kinds of cessions by way of reinsurance that are allowed, expenses and commissions, settlement of losses, liability information, and withdrawals.

These exchanges are usually obligatory, the ceding company being under obligation to cede to members through the clearing house its first surplus. The interest and liability of each member, however, is several and not joint, i.e., each member bears individually all losses on reinsurance ceded to it through the clearing house and also pays the same promptly through that organization. Usually it is also provided (1) that the amount ceded by any one member shall not exceed a stipulated sum, varying according to the character of the risk; (2) that the amount ceded shall not exceed the net amount retained by the ceding company at its own risk, exclusive of treaty and other reinsurance; (3) that in no case should the net retention be less than the amount stated in the agreement; and (4) that in no case shall the amount ceded by any one member exceed a certain amount on any one risk located in certain defined districts of a hazardous nature. Illustrations of this type of reinsurance arrangement in the American fire insurance business are the "Reinsurance Clearing House" and the "American Reinsurance Exchange."

"Share" or "participating arrangements."—This form of reinsurance agreement, widely used in marine insurance, provides that the original underwriter will give his reinsurers a definite share (a proportion like one-sixth) of his business. Sometimes the agreement extends only to a single account placed by the original underwriter for his client. Sometimes the agreement covers a stated interest in all

business falling within some definite group, such as a described route of travel. In still other instances two or more companies may agree to reciprocate—mutually share in each other's risks, although the respective proportions allowed may be different—as regards all their business wherever written. Such a plan is often used where several companies are under the management of a single office.

Reinsurance "pools" or "syndicates."—These are share or participating arrangements whereby a number of companies—varying from as many as 10 to 36 in some of the leading American examples of such agreements in marine insurance—arrange among themselves to share all insurance on a given commodity or on all business within a given territory on the basis of certain agreed proportions. Thus, in the "Cotton Reinsurance Agreement," the distribution of risks is on the basis of an agreed number of shares, each company issuing a direct policy to the insured, and ceding to the other companies a share of each risk in accordance with the stipulated percentages. Some 26 interests are parties to the arrangement, representing a total of 120 shares. One interest, involving four companies, represents 20 shares; another interest, composed of two companies, 20 shares; another interest, representing three companies, 15 shares; another interest of two companies, 9 shares; and still another interest, involving four companies, 8 shares. The remaining shares are represented by companies, two of which represent 12 shares each; one, 10 shares; three, 3 shares; two, 2 shares; and three, 1 share each.

Other arrangements³ of a similar nature are the "Cotton Fire and Marine Underwriters," the "Burlap Agreement," the "Lumber Reinsurance Association on the Great Lakes,"

³For a detailed discussion of these various "pools" or "syndicates," see S. S. Huebner: "Marine Insurance," Chapter XIV on "Reinsurance Agreements in Marine Insurance."

the "Inland River Agreement," the "New Orleans River Association," the "American Foreign Insurance Association," and the "American Marine Insurance Syndicates, 'B' and 'C'." All except the last named relate to the insurance of cargo, whereas Syndicates "B" and "C" refer only to the insurance of American hulls. Syndicate B, comprising nearly 50 American companies, was organized to insure American steamships sold by the Shipping Board on the part-payment plan. Syndicate C, comprising over 70 American and foreign admitted companies, was organized to insure all American steel hulls owned by private persons or corporations or in which they have an insurable interest. In each case the risk is accepted by the manager for the Syndicate, and is automatically distributed among all the companies, each taking its allotted percentage.

Excess reinsurance.—Despite the distribution of risk through share or participating agreements, marine underwriters may still be left with a liability exceeding the normal line customarily retained. Such excess liability may be shifted to other underwriters through so-called "excess reinsurance contracts," which describe definite time and geographical limits and which apply as soon as the original underwriter has an excess liability under all his contracts, including reinsurance arrangements as well as policies issued directly to clients.

Reinsurance covering excess loss.—Here the reinsurer's liability is based upon the amount of loss in excess of a stipulated sum and not upon the amount at risk. The agreement is to the effect that no claim is to be paid by the reinsurer unless the original company has paid or becomes liable to pay to its policyholders on account of loss by any one disaster, a sum exceeding, let us say \$50,000, and then for a sum not exceeding \$100,000 upon the excess thereof. The chance of loss under this type of reinsurance

contract, it must be apparent, is considerably less than under other forms of excess reinsurance, the risk depending upon the amount of loss which the original underwriter agrees to assume before making a claim under his reinsurance contract. The reinsurer is liable only for losses in excess of this figure, and except in rare instances, does not become liable for partial losses. In this respect it differs from excess reinsurance based upon the amount at risk, where the reinsuring company is a coinsurer in the sense that it must pay losses in the proportion that the amount insured under the reinsurance contract bears to the total insurance granted by the reinsured company on the property in question.

Application of the Reinsurance Contract to the Original Insured.—By the great weight of authority the insured (the owner of the property) is regarded as a stranger to the contract of reinsurance, unless it is specifically agreed that he shall have an interest therein. In other words, when one company reinsures the risk of another, the contract is considered as having been made only between these two companies, and the reinsuring company is liable only to the reinsured company and not to the policyholder. If property owner "A," for example, insures his property for \$50,000 with Company "B," and "B" reinsures \$25,000 of this risk with Company "C," then "C" will be liable only to "B" and not to the policyholder, "A." In case "B" should be insolvent, it follows that "A," in case of a total loss, cannot collect the \$25,000 directly from "C." This sum will be paid to the bankrupt concern and when merged with the other assets for the general benefit of creditors may somewhat enlarge the dividend paid to "A" as a creditor, but he will nevertheless suffer a loss.

State Regulations Pertaining to Reinsurance.—Adequate reinsurance facilities, resulting in a proper spread of business, are of supreme importance to sound under-

writing. The great majority of our states seem to have made it unnecessarily difficult for companies to enlarge their reinsurance facilities with other American underwriters. In 19 states, insurance companies are limited in their search for reinsurance facilities only to companies that are authorized to transact business within the individual state under consideration. Twenty-five other states permit risks written within their jurisdiction to be reinsured with non-admitted companies, but in nearly all instances, subject to severe restrictions, such as a refusal to permit a ceding company any reduction of taxes where the reinsurance is effected with a company unauthorized to issue policies in the state. Numerous states allow no credit for either taxes or reserve liabilities where reinsurance is ceded to non-admitted companies. Some states allow reinsurance to unauthorized companies only when the facilities of admitted companies have first been exhausted, and require an affidavit to this effect from the ceding company. Three states require the direct-writing company, when ceding insurance to unauthorized companies, to pay a higher tax on the business ceded than the usual premium tax imposed.

The foregoing gives unmistakable evidence that American legislation with respect to reinsurance has been narrow and restrictive in character, and is out of harmony with the prompt, convenient and economical distribution of large risks so necessary in modern business. To enlarge the reinsurance opportunities of American companies, the law of New York and Massachusetts provides that every insurance or reinsurance company, authorized to transact insurance or reinsurance in the state under consideration, is permitted to reinsure any part of an individual risk with (a) a company licensed in the state, or (b), and this is the important feature, a company licensed in any other state of the United States which shows the same standards of

solvency as would be required if it were at the time of such reinsurance authorized in the state under consideration to insure risks of the same kind as those reinsured. Such a plan also received the endorsement of the Federal Government in the Act of March 4, 1922, for the regulation of Marine Insurance in the District of Columbia.

CHAPTER XIV

POLICY ENDORSEMENT IN FIRE INSURANCE

Standard Policy Not Adapted to Meet All Kinds of Circumstances.—The standard fire policy was necessarily prepared with reference to a general situation. Yet many property owners are confronted by special circumstances that make a modification of, or addition to, existing policy provisions highly desirable, or that require the incorporation of new agreements not suggested in the printed portion of the policy. In fact, the policy recognizes the necessity for special arrangements since it provides that "any other agreement not inconsistent with or a waiver of any of the conditions or provisions of this policy may be provided for by agreement in writing added hereto." Such agreements take the form of printed or written endorsements on the policy, sometimes called "forms," "clauses," or "riders." When attached to the policy such endorsements take precedence over any provisions in the contract with which they may be in conflict. Being of an even or later date than the policy, they are assumed to represent the latest meeting of the minds, and thus constitute the last agreement of the parties to the contract.

In previous chapters extended reference was made to a considerable number of very important clauses, such as the mortgagee, loss payable, other insurance permitted, coinsurance, distribution, pro rata, three-fourths value, three-fourths loss, two-thirds vacancy, and reinsurance clauses. But there are hundreds of other endorsements

in use, designed to meet almost every special situation that may confront the applicant for insurance. A knowledge of these clauses and their application to meet special situations should be the object of every broker and agent who wishes to serve his client well. It is through their use that property owners may secure the most adequate protection at the lowest possible cost. With comparatively few exceptions the numerous endorsements may, roughly speaking, be divided into the following classes:

Forms or Clauses Descriptive of the Property or Interest Insured.—Previous chapters contained an explanation of the two sections of the standard policy relating to (1) the description of the property, and (2) the character of the ownership or interest of the insured. In both respects numerous situations arise for special treatment through endorsements. The forms and clauses referred to may be classified into those:

Describing the property.—The standard policy covers “the following described property while located and contained as described herein, but not elsewhere, to wit.” Following these words a large blank space is provided for the description of the property or interest. But owing to the thousands of agents writing policies, it is highly inadvisable to give full freedom in drafting the description called for. To do so would mean an enormous increase in the number of non-concurrent policies, especially in view of the numerous instances where many policies cover the same property and where the property consists of several or many distinct items. In many cases, the description must necessarily be elaborate, and there is danger of the agent making the same inaccurate or incomplete. Experience has also demonstrated the advisability of making the policy, wherever possible, specific as regards the amount of insurance on each of the various items covered. To meet

all of these considerations hundreds of "building" and "contents forms" have been drafted in the form of printed riders that contain an extended and careful description of each class of property together with the specific amount of insurance attached thereto. Among the leading forms may be mentioned the "dwelling form," "household and furniture form," "private garage and contents form," "dwelling, household, furniture, stable, and contents form," "standard farm form" (often containing as many as twenty-five different items to each of which a specific amount of insurance is made to attach), "church building and contents form" (other forms relate to schools, libraries, and other public buildings), "mercantile building and fixture form," "merchandise and fixture form," "mercantile, building, fixtures and stock form," "country store form," "manufacturing building form," "machinery and stock form," and "manufacturing special hazards form." Numerous other forms relate to the buildings, stock or equipment of specialized businesses, such as jewelers, photographers, grain elevators, cold storage plants, coal mining properties, lumber yards, power plants, street railway companies, oil plants, moving picture theaters, etc.

Describing the insured's interest.—Ownership may not be sole and unconditional, and insurable interest, as we have seen, may assume a great variety of forms. Hence, numerous clauses are used to protect the insured adequately by defining his title or interest. Thus the insurance may be made payable "as interest may appear," "as now or may be hereafter constituted," or "for whom it may concern." Other endorsements serve to describe the insured interest in estates, or to continue the policy in force, in the event of the death of the insured, "for the benefit of the heirs, administrators, or assigns as interest may appear."

Permitting changes in the location of the property.—

Location of the insured's property, as already explained, is a vital consideration in fire insurance, and the policy covers only with respect to the location described. Circumstances, however, may make a more flexible treatment desirable. Accordingly, it may be agreed by endorsement that the property may be moved to another location, or that it will be covered while contained in one of a number of locations, such as "in or on buildings, additions and extensions." Many types of property must necessarily move from one location to another. To meet such situations insurance companies issue "floating," "tourist," and "excess floater" forms. The last form is designed to protect property in different locations to the extent that any specific insurance applying to any particular locality may prove insufficient.

Allowing an adjustment in the insurance coverage.—

Reference is had to such clauses as permit a change in the items covered, by either omitting some or adding others; register a partial cancellation; reinstate the policy for its original amount in the event of a partial loss payment; or record the fact on the mortgagor's policy that the mortgage claim has been satisfied.

*Extending the insurance coverage.—*The standard policy limits the company's liability to "direct loss and damage by fire," and in this connection distinctly states that there shall be no liability "for loss resulting from interruption of business or manufacture." Yet owners may find it desirable, or even imperative to be protected against (1) the loss of profits resulting from inability to operate a factory or other business owing to a fire; (2) the loss of rent because a fire has rendered the building uninhabitable; and (3) the loss of commissions and profits on stocks of goods owing to their destruction by fire. By special endorsement the insured may be pro-

tected against any of these contingencies. These additional types of coverage—commonly known as “use and occupancy,” “rent” and “profit” insurance—have assumed such large proportions in recent years that they will be made the subject of a separate chapter.

Without a special agreement to the contrary, fire policies do not cover water damage occasioned by automatic sprinklers when their action is not attributable to fire. This hazard is ever present in any sprinklered risk, and accordingly, companies are willing to grant by agreement so-called “sprinkler leakage insurance.” Again, the “guest or servant clause” extends the insurance to the belongings of any member of the family or servants.

Endorsements Limiting or Distributing the Indemnity.

—Justice between different property owners requires that fire insurance be written subject to coinsurance, and practically all policies covering mercantile and manufacturing risks are, therefore, endorsed with 80 per cent, 90 per cent or 100 per cent coinsurance clauses. In other instances, it is desirable to control the moral hazard, or to induce the insured through self-interest to safeguard his property by the exercise of every possible precaution. To thus increase the owner's incentive, a three-fourths value or three-fourths loss clause may be applied to the insurance. In still other instances, where the property is situated in different localities, so-called “distribution” or “pro rata” clauses are used. Again, where the property consists of distinct items, special forms are attached separating the insurance with a view to allocating a specific amount of indemnity to each item.

Endorsements Decreasing the Hazard.—Certain risks are not desired by the insurer at all, or, if assumed, the acceptance is often based upon the existence or observance of definite conditions. The leading clauses decreasing the hazard are:

(1) Those prohibiting the use of certain articles or methods of generating heat, light, and power. As examples of such clauses in common use are the so-called "dynamo clause," which exempts the company from loss or damage to dynamos, switches, or other electrical appliances that may be caused by electrical currents, artificial or otherwise, unless the same occur in consequence of fire outside of the appliances themselves; the "spontaneous combustion clause," which frees the company from liability for loss occasioned by the spontaneous combustion of certain articles on the insured premises; and the "consequential damage clause," which protects the company against indirect or consequential loss, as for example, loss or damage caused by change of temperature occasioned by the destruction of heating, refrigerating or cooling apparatus. Sometimes these clauses are made to apply to specific properties or articles, in which case they are given special names such as "cold storage warehouse clause," "bituminous coal clause," etc.

(2) Those permitting the use in certain places of hazardous articles (like acetylene gas and gasoline), processes of manufacture, and methods of generating heat, light, and power. These permits, however, require the observance of definite conditions. As a rule they are very detailed in character, and often contain half a dozen or more warranties, together with a considerable number of "cautions" as to the proper use and installation of the articles or processes.

(3) Those requiring the premises to be occupied only by the owner and his family, or, in the event of manufacturing and mercantile risks, limiting vacancy or un-occupancy only to one-third of the establishment.

(4) Those providing for the proper maintenance of fire protective appliances. Thus the "signaling system clause" stipulates that in view of the described premises

being fully equipped with a good automatic fire alarm system, etc., a reduction is made in the premium, but on the understanding that if the apparatus is at any time removed at a later date, or becomes inoperative, the company shall at once receive notice of the fact, and a pro rata portion of the reduction in the premium shall be refunded to the company for the unexpired term of the policy. Likewise the "automatic sprinkler clause" provides for due diligence on the part of the insured to maintain such equipment in complete working order during the term of the insurance.

Permits, Mostly Suggested by the Policy, which Increase the Hazard.—The standard policy enumerates a considerable number of hazards, the existence of which, "unless otherwise provided by agreement in writing added hereto," frees the insurer from liability for loss or damage. The policy itself, therefore, suggests the method by which the insured may obtain privileges, by way of endorsed permits, which run counter to the original policy restrictions. Many of these permits merely require enumeration in order to be understood. Others, however, are variously interpreted and require a brief explanation. Stated in the order of the appearance of the subject-matter in the policy, the endorsements referred to are those permitting:

(1) An increase in the hazard by any means within the knowledge or control of the insured. Innumerable methods of increasing the hazard following the issuance of the policy may be mentioned, such as the introduction of new processes or the discontinuance of fire prevention precautions. This section of the policy, however, is generally held to include only changes in the hazard which are of a durable rather than of a temporary character. Nor does this provision refer to an increase in the hazard

of adjacent buildings, since these are not within the insured's control.

(2) Alteration or repair of the described premises by mechanics beyond a period of fifteen days.

(3) Generation of illuminating gas or vapor on the described premises; or the maintenance or use on such premises ("any usage or custom to the contrary notwithstanding") of "fireworks, Greek fire, phosphorus, explosives, benzine, gasoline, naphtha or any other petroleum product of greater inflammability than kerosene oil, gun powder exceeding twenty-five pounds, or kerosene oil exceeding five barrels." As previously noted, some of these prohibited articles are permitted if used in strict compliance with certain warranties. The phraseology, "any usage or custom of trade or manufacture to the contrary notwithstanding," was adopted to overcome certain court decisions which held that some of these prohibited articles must, by usage or custom, be considered as constituting a part of a designated trade, and that the policy is issued in view of such usage or custom. Nothing would seem less ambiguous than the clause as it now stands; yet despite the qualifying phrase certain courts have continued to follow their previous rulings.

(4) Operation of the premises, in whole or in part, if a manufacturing establishment, "between the hours of 10 P.M. and 5 A.M.," or cessation of operation "beyond a period of ten days." The policy provision that a manufacturing establishment may not be operated at night later than 10 o'clock, or that it may not cease operation for more than ten consecutive days, unless the consent of the insurer is obtained, must in most localities be construed with reference to the nature of the business under consideration. In most instances violation of this clause will not lead to a forfeiture where a temporary

suspension of the business occurs, owing to unusual and unavoidable interruptions, such as, for example, the cessation of water power.

(5) Vacancy or unoccupancy beyond a period of ten days. The standard policy provision stipulating that the insurance becomes null and void "while the described building, whether intended for occupancy by owner or tenant, is vacant or unoccupied beyond a period of ten days," is a most important one and was made expressly to read "vacant or unoccupied." The word "unoccupied" refers to those cases where the building has been abandoned for its ordinary uses, whereas the term "vacant" implies not only abandonment, but also removal of the furniture, fixtures, etc. Fire underwriters have thoroughly learned the lesson that vacant or unoccupied buildings are much more apt to burn than those which are inhabited and used. Not only is the moral hazard connected with such properties a bad one, because of their unproductivity, but the risk is greatly augmented because of the absence of persons who can exercise a watchful care. When a vacancy permit is granted, it is often agreed that the "building shall be under the supervision and care of some competent person." In other instances, vacancy is permitted to only a limited extent, such as one-third of the establishment.

(6) Coverage for loss by explosion or lightning, even though no fire ensues. The standard policy expressly exempts the company from liability for loss "by explosion or lightning unless fires ensue, and, in that event, for loss or damage by fire only." The so-called "lightning clause" covers loss or damage caused by lightning itself, meaning thereby the commonly accepted use of the term, and excluding loss attributable to cyclone, tornado, or windstorm.

(7) The placing of a chattel mortgage on the insured property, without that type of encumbrance violating the policy provision relating to this particular kind of mortgage.

(8) Continued coverage of an insured building if it, or any material part thereof, has fallen, without the damage having been occasioned by a fire. In the absence of an agreement the standard policy provides that it "shall immediately cease" under the circumstances referred to. This provision was introduced in the policy on the theory that when an insured building has fallen, in part or in whole, it is no longer the original building that burns, but simply the débris.

In addition to the various endorsements just described there are many other privileges which the insured may obtain by special agreement with the insurer and which are not suggested by any of the provisions in the standard policy. Almost any kind of a special agreement may be entered into by the parties to the contract, which, when endorsed on the policy, will supersede the regular policy provisions and will constitute the latest agreement. Thus the policy contains an extended section enumerating excluded types of property such as currency, manuscripts, drawings, evidences of debt, etc. By special agreement, however, such articles may be accepted for purposes of insurance. Again, other clauses are used which give consent for foreclosure proceedings, or protect the insurance against invalidation by the act or neglect of any other occupant of the premises.

CHAPTER XV

USE AND OCCUPANCY, PROFITS, AND RENT INSURANCE

The Fire Policy Incomplete in its Coverage Against Loss by Fire.¹—The standard fire policy only protects property against “direct loss or damage by fire” and expressly provides that it limits recovery to the cost of replacement or reproduction. Yet in the overwhelming number of cases, the amount of loss occasioned by fire is not limited to the value of the property actually destroyed. The manufacturer, whose factory is partially or totally suspended in its operation through a fire, loses valuable profits during the period of suspension, as well as such maintenance expenses and fixed charges as cannot be discontinued despite the interruption of the business. The same may also be said of merchants and numerous other types of business men. Owners or commission men holding merchandise for sale, or, if already sold, holding the same for shipment or delivery, stand in position to lose all their profits or commissions should the goods be destroyed. Likewise, owners of buildings, destroyed or damaged by fire, will lose the rental income during the time that it takes to restore the property to

¹For a detailed discussion of the forms of insurance discussed in this Chapter the reader is referred to Robert P. Barbour: “Agent’s Key to Fire Insurance,” Chapters XII and XIII; “Rent, Rental Value and Leasehold Insurance,” a pamphlet published by the Insurance Company of North America, 1920; and “Use and Occupancy Insurance,” a pamphlet published by the Insurance Company of North America, 1919.

an inhabitable condition. In fact, numerous instances may be cited, especially when the property damage is only partial, where the loss resulting from the interruption to business greatly exceeds in seriousness the value of the property actually destroyed.

Until recently such losses of profit, maintenance expenses, and rent were regarded as unavoidable and were accepted as a matter of course. Yet they should be the subject of insurance quite as much as the property itself. They are insured to-day by all leading fire insurance companies under three main types of coverage, viz., "use and occupancy insurance," "profits and commissions insurance," and "rent insurance." The last type, in turn, may be classified into "rent," "rental value," and "leasehold" insurance. While all these kinds of insurance are similar in their general purpose, the special forms under which they are written (and which are attached to the standard policy) differ greatly in their provisions. Moreover, various companies also issue separate policies under which use and occupancy, profits, and rentals are protected if the property is damaged or destroyed by wind-storm, explosion, riot, sprinkler leakage, etc.

Use and Occupancy Insurance.—*Meaning and application.*—This type of insurance is designed to reimburse manufacturers, merchants, warehousemen and others for (1) the loss of profits and (2) the loss of continuing and unprofitable maintenance expenses and fixed charges, occasioned by the suspension or interruption of their business through fire. The great need for such insurance must be apparent. When manufacturers, merchants or warehousemen are prevented by fire from continuing the production, sale or storage of goods, the indirect loss often exceeds the value of the property actually destroyed. Yet the standard fire policy provides that the company shall not be liable for "compensation for loss

resulting from interruption of business or manufacture." Hence, the desirability of attaching a special form to the policy which enlarges the insurance coverage to include the above-mentioned items. Only in this way can the insured be protected against the loss of net earnings, the payment of unavoidable, but under the circumstances, unproductive expenses, the disintegration of his organization and the possible inability, owing to the effects of financial drain, ever again to restore his property to a state of profitable operation.

Use and occupancy insurance is effected by the occupant of the premises, whether owner or tenant. The insurance usually applies to the building, equipment, and necessary raw materials used in the business under consideration, but does not cover finished stock or merchandise for sale. As will be explained later, the last two items are usually covered under a profits policy. Attempts at the use of a standard use and occupancy form have been made, but with comparatively little success. Conditions surrounding different types of business vary so greatly with respect to the problems arising in the application of this form of insurance, and the same may also be said of profits and commissions insurance, that the use of some one standard form of wording has been found impracticable.² Accordingly, many different forms

² The following serves to illustrate the form used in connection with use and occupancy insurance for manufacturing plants:

COPY OF USE AND OCCUPANCY FORM
(For manufacturing risk)

\$..... On the use and occupancy of situated
..... and occupied for

If the said building and machinery equipment be destroyed or so damaged by fire as to necessitate a total or partial suspension of manufacturing, this company shall be liable under this policy for loss of net profit on goods the production of which is thereby prevented, and for such fixed charges and expenses

have been devised to cover the situation with reference to manufacturing plants or various other types of business, such as street railway properties, coal mining operations, mercantile establishments, warehouses, chemical laboratories, hotels, theaters, schools, etc. Valued poli-

as must necessarily continue during a total or partial suspension of manufacturing, for not exceeding such length of time as would be required under ordinary circumstances to rebuild, repair or replace such part of said building and machinery equipment as may be destroyed or damaged (not limited by the date of expiration of this policy), under the following terms and conditions, to-wit:

During the time of a total suspension of manufacturing under this policy shall not exceed one-three hundredth ($1/300$ th) part of the amount of this policy for each working day.

During the time of a partial suspension of manufacturing, liability under this policy shall not exceed that proportion of the per diem liability for a total suspension of manufacturing which the daily average decrease in the production of goods bears to the daily average production for a period of three hundred (300) days' time immediately prior to such suspension.

It is a condition of this insurance that liability is based on not less than three hundred (300) working days to the business year.

The word "day" or "working day" as used in this contract shall be held to cover a period of twenty-four (24) hours.

Liability hereunder shall not exceed the amount of insurance by this policy nor a greater proportion of any loss than the insurance thereunder shall bear to all insurance, whether valid or not, covering in any manner the loss insured against by this policy.

The production of goods for or by the assured elsewhere than in the above described building, because of and during such suspension, shall be considered the same as goods manufactured therein, except that liability hereunder shall extend to the necessary decrease in profits thereon.

This policy applied only to the buildings and machinery that contribute to the completion of the work of this plant, and all storehouses and contents are excluded unless specifically provided for herein.

Surplus machinery or duplicate parts thereof, equipment or supplies, which may be owned, controlled or used by the assured shall, in the event of loss, be used in placing the property in condition for operation.

In case the assured and this company are unable to agree as to any question affecting the amount of loss under this policy, the same shall be determined by appraisers in the manner provided by the policy hereto attached, the provisions of which policy shall govern in all matters pertaining to this insurance, except as herein otherwise provided.

cies are, as a rule, avoided, and an effort is usually made to use the preceding year, or some other past period, as the basis for estimating the value of use and occupancy or profits for the particular premises to be insured.

Items usually constituting the value of use and occupancy.—The use and occupancy form usually provides, using the manufacturing form as a basis, that “if the said building and machinery and equipment be destroyed or so damaged by fire as to necessitate a total or partial suspension of manufacturing, this company shall be liable under this policy for loss of net profit on goods the production of which is thereby prevented.” Further provision is also made to the effect that the company shall be liable for “such fixed charges and expenses as must necessarily continue during a total or partial suspension of manufacturing but not exceeding such length of time as would be required under ordinary circumstances to rebuild, repair or replace such part of said building and machinery and equipment as may be destroyed or damaged (not limited by the date of expiration of this policy) etc.” Such fixed charges and expenses are sometimes enumerated in the form as comprising “rent, interest, taxes, royalties for machinery (or processes) which have to be paid regardless of the operation of the plant, salaries (under contract), payroll relating to employees who must be retained in order to resume promptly after damage is repaired, cost of lighting, heating, attendance and general maintenance consistent with suspension of business during the time necessary for repairs.”

Policy definition of buildings, machinery and equipment.—The premises contemplated under the use and occupancy insurance should be described specifically (by city, block boundaries, number of lot and number of building) and not in general terms. Buildings and contents which are regarded by the insured as not contributing to the use and

occupancy value of the property may be specifically excluded from the insurance. But it is highly important that the property intended to be covered should not be described so vaguely, with reference to location, as to possibly include properties that were neither known nor contemplated by the company at the time of the issuance of the insurance.

To explain definitely the precise application of use and occupancy, nearly every form specifies the meaning of "building" "machinery," etc. Thus, the manufacturing form usually stipulates that "this policy applies only to buildings and machinery that contribute to the completion of the work of this plant, and all storehouses and contents are excluded unless specifically provided for herein." Further provision is usually made to the effect that "surplus machinery or duplicate parts thereof, equipment or supplies, which may be owned, controlled or used by the insured shall, in the event of loss, be used in placing the property in condition for operation." It is also stipulated as a rule that "the production of goods for or by the insured elsewhere than in the above described building, because of and during such suspension shall be considered the same as goods manufactured therein, except that liability hereunder shall extend to the necessary decrease in profits thereon."

Company's liability under use and occupancy insurance.
—Subject to all the definitions and conditions contained in the policy, the company's limit of liability is defined on a per diem basis. For concerns which do not operate Sundays and holidays the year is usually assumed to comprise 300 days, and the month 25 days. Where, however, the business involves "constant and continuous earnings," as in the case of power plants, hotels, etc., the year or month is usually assumed to contain 365 and 30 days respectively. Accordingly, the company's limit of loss per day

for total suspension of business is usually $\frac{1}{300}$ th (or $\frac{1}{365}$ th) of the amount of the policy. On the basis of this daily limit of liability and the prescribed number of working days in the year, it is clear that the company's liability cannot exceed the amount of the annual policy.

In the event of total suspension, assuming a manufacturing risk and a year of 300 days, the policy usually states that the company's liability "shall not exceed one three-hundredth ($\frac{1}{300}$ th) part of the amount of this policy for each working day." During the time of a partial suspension, however, liability under the policy is usually defined as "not exceeding that proportion of the per diem liability for a total suspension of manufacturing which the daily average decrease in the production of goods bears to the daily average production for a period of three hundred (300) days' time made prior to such suspension." The word "day" or "working day" is declared by the policy to cover a period of 24 hours. In the case of seasonal risks, a three months' risk, for example, the company's per diem liability is adjusted accordingly, i.e., is defined as $\frac{1}{75}$ th or $\frac{1}{90}$ th of the amount of the policy for each working day. Again, where the results of the business vary greatly according to the time of the year, the policy may specify "that this insurance shall pay the sum stated below for each day of total prevention during each month specified." Thus, for the month of January the payment per day may be arranged at \$5,000 and the total payment for the month at \$130,000, for February \$4,000 per day and \$104,000 for the month, etc.

Other leading provisions and endorsements.—Since use and occupancy insurance is written under a special form attached to the standard policy, the endorsements required are usually those which would be attached to a fire policy covering the same property. The same may also be said of profits and commissions insurance. To avoid any mis-

understanding, however, the use and occupancy form usually has incorporated within it a contribution clause and an appraisal clause. The first specifies that the use and occupancy liability of the company "shall not exceed the amount of insurance by this policy, nor a greater proportion of any loss than the insurance thereunder shall bear to all insurance, whether valid or not, covering in any manner the loss insured against by this policy." The appraisal clause makes direct reference to the fire policy to which the use and occupancy form is attached and provides that "in case the insured and this company are unable to agree as to any question affecting the amount of loss under this policy, the same shall be determined by appraisers in the manner provided by the policy hereto attached, the provisions of which policy shall govern in all matters pertaining to this insurance except as herein otherwise provided." The lightning hazard is also usually assumed. Under separate policies, it should also be stated, companies often assume liability for loss of use and occupancy, profits and commissions, occasioned by explosion, windstorm, riot and sprinkler leakage.

Limitation of the company's per diem liability to $\frac{1}{300}$ th or $\frac{1}{365}$ th of the amount of the policy, it should be observed, fulfills the purpose of full coinsurance. Accordingly, it is not usual to find a coinsurance provision in the use and occupancy form. Under the arrangement the insured may take insurance for only a part of what he regards the full value of the use and occupancy of his premises. But whatever proportion of this value he elects to insure, it is clearly stated in the policy that he is entitled to receive from the company only $\frac{1}{300}$ th or $\frac{1}{365}$ th of the amount of insurance thus actually taken. The amount of the per diem recovery is, in other words, reduced in the exact proportion that the insured fails to insure the full value of his use and occupancy. Where, however, as in profits and commissions

insurance on finished stock or merchandise for sale, no provision is made for a per diem liability, insurance companies usually follow the practice of attaching a coinsurance clause.

Profits and Commissions Insurance.—*Leading differences between profits insurance and use and occupancy insurance.*—Profits and commissions insurance differs from use and occupancy insurance in two very essential respects. Whereas use and occupancy insurance involves recovery of the loss of *profits, maintenance expenses and fixed charges*, profits insurance, unless some special arrangement to the contrary has been entered into, covers only against the loss of *net earnings* obtained from the use and occupancy of the insured property. Again, profits and commissions insurance usually covers finished stock and merchandise for sale, while use and occupancy insurance, as already explained, relates to buildings, machinery and equipment, and contemplates recovery for loss arising out of the inability to use the insured premises.

Nature of the protection under profits insurance.—Under this form of insurance the owner of goods held for sale, or if already sold, held for shipment, may insure himself against the loss of profits resulting from the destruction of the merchandise by fire. Various plans may be used to determine the measure of recovery under the policy. One method consists of making the profit contemplated under the contract equal to the difference between cost of production and selling price, making due allowance for any customary discount. Or the recovery may be defined as a fixed percentage of the selling price. Under still another method the recovery is placed at a fixed percentage of the amount of stock actually lost, making due allowance for any profit derived from the sale of the salvaged portion.

Nature of the protection under commissions insurance.—Various persons, besides the owner, may have an insurable

interest in merchandise in the form of an expected profit or commission that may be lost should the goods be destroyed. Such profits or commissions it is the function of commissions insurance to indemnify. Commission merchants are thus enabled to protect their profits or commissions on the goods of others which they are holding for sale on their own or other premises, or which if already sold are being held for delivery. Such interest in prospective commissions may even be extended to instances of inability on the part of a manufacturer to deliver goods, as per contract, owing to the partial or complete suspension of his plant through fire. In that event the commission merchant may be promised protection to the extent of a stipulated percentage of the cost or sales price of the merchandise that would have been delivered under normal conditions. Again, a given business may be dependent for its own operation upon the regular delivery of definite amounts of merchandise at definite contract prices. Yet suspension of the plant that produces the goods promised under the contract might necessitate the purchase of similar merchandise elsewhere at probably much higher prices. To meet such a contingency, insurance may be effected that will entitle the insured to recover the loss represented by the difference between the contract price and that actually paid.

*Policy provisions under profits and commissions insurance.*³—A great variety of forms, extending insurance to

³The following represents one of the forms used in connection with profits and commissions insurance:

PROFITS AND/OR COMMISSIONS FORM

\$..... On the profits and/or commissions of the insured on merchandise, sold or unsold, contained in

If during the term of this policy such merchandise, or any portion thereof, shall be destroyed or damaged by fire, this company shall be liable for its pro rata share of any ascertained loss of

profits and commissions, are used to meet the special need of the situation. In fact, the adoption of a standard form is just as difficult here as was noted in connection with use and occupancy insurance. The form referred to in this Chapter limits the company's liability to "its pro rata share of any ascertained loss of profits or commissions on the described merchandise which may result from such fire, not exceeding, however, its pro rata share of per cent of the damage sustained by such merchandise, which damage shall be determined by the final outcome of the adjustment of the loss on merchandise by companies insuring same, including results of any salvage handling operations, whether completed before or after such adjustment; or, if there be no insurance on said merchandise, then by such ascertainment and estimate by the parties hereto as is provided for in the printed portion of this policy."

Other forms, however, limit the recovery to a stated percentage of the selling price or to some other basis. But it will be observed that the insured's recovery is not reckoned, as in the case of use and occupancy insurance, upon a per diem basis. Sometimes also the insured covenants to keep complete accounts, to protect such records in a fireproof safe during non-business hours, and in the

profits and/or commissions on such merchandise which may result from such fire, not exceeding, however, its pro rata share of per cent of the damage sustained by such merchandise, which damage shall be determined by the final outcome of the adjustment of the loss on merchandise by companies insuring same, including results of any salvage handling operations, whether completed before or after such adjustment; or, if there be no insurance on said merchandise, then by such ascertainment and estimate by the parties hereto as is provided for in the printed portion of this policy.

It is understood and agreed that the words, "the property described" and "the actual cash value of said property," in the average clause hereto attached are to be interpreted as meaning per cent of the actual cash value of the merchandise described.

(Add usual clauses).

event of loss, to produce the same, with the understanding that a failure in any of these respects will nullify the policy and preclude any suit or action at law to recover a loss.

Rent, Rental Value, and Leasehold Insurance.⁴—*Nature of service performed.*—This form of insurance renders to properties that are or may be rented the same general service that is performed by use and occupancy insurance to manufacturing and mercantile establishments. When a rented property is partially or totally destroyed the owner loses more than the property itself. He also loses the rental until the building is restored to an inhabitable condition. During the period of reconditioning he is also obliged to pay taxes, and perhaps interest on a mortgage. Managers of estates and trust funds, invested in rent producing buildings, it should be stated, are finding rent insurance extremely useful. Even where the building is occupied by

⁴The following is illustrative of the rental value form, whether the premises are rented or vacant:

RENT FORM
(Rented or Vacant)

“\$. On rents of the building situate

It is hereby understood and agreed that if the said building, or any part thereof, whether rented at the time or not, shall be rendered untenable by fire or lightning, this Company shall be liable for the rental value of such untenable portions, loss to be computed from date of fire or lightning damage until such time as the building could, with reasonable diligence and despatch, be rendered again tenable.

If the insured occupies any portion of said building, a fair rental value of the portion so occupied shall be considered as a part of the rents insured.

In consideration of the reduced rate at which this policy is written, it is agreed that this Company shall not be liable under this policy for any greater proportion of any loss than the sum hereby insured bears to the full annual rental value of the said premises.”

Note: Instead of “full annual rental value” the following clause is sometimes used:

“Bears to the full rental value of the said building for the time that would reasonably be required to rebuild and restore it to a tenable condition if it were totally destroyed.”

(Attach usual clauses).

the owner, account must be taken of the loss of its use to him.

Meaning of the several types of coverage.—It is necessary to recognize the distinction between “rent” and “rental value” as used in connection with this type of insurance. “Rent” represents the sum paid by the tenant for the use of the property under consideration, and rent insurance protects the owner against loss through the discontinuance of such rental owing to a fire. “Rental value,” on the contrary, “is a term used when the owner occupies the building, and represents the sum for which he could rent it; or the sum he would have to pay for the use of a building the same size and its equal in every way.”⁵ Rental value insurance, therefore, protects the insured against the building he occupies becoming untenable.

Leasehold insurance⁶ protects the lessee of a building against the loss of leasehold profit or leasehold value. When obtaining a property under lease, the lessee will seek to do

⁵ Definition in “Rent, Rental Value and Leasehold Insurance,” a pamphlet published by the Insurance Company of North America, 1920, page 4.

⁶ The following is an example of the leasehold interest form:

LEASEHOLD INTEREST FORM

\$..... on leasehold interest (term of rent from date (a)) to (date (b)) in the building, situate

It is understood and agreed that, if said building shall be totally destroyed by fire, occurring during the term and under the conditions of this policy, this Company shall pay the whole amount hereby insured, less a deduction of \$..... per month for the time that shall have elapsed between the date of (date (a)) and the date of occurrence of said fire. And in case of such damage by fire as shall, without total destruction, render said building untenable, this Company shall pay at the rate of \$....., per month, to be computed from the date of such fire to the date when, by due diligence, the said building could be repaired and rendered fit for occupancy; but in no case shall this Company be liable for a greater amount than the sum insured, nor for any loss other than that which may arise under said leasehold interest.

(Attach Lightning Clause, and other necessary clauses).

one of two things. He may sub-let the property at a higher rental, in which case the difference between the rental he pays and the one he receives represents a rental profit. Or he may occupy the property himself, in which case the difference between the rental he pays and the one he would be obliged to pay if deprived of the property represents a leasehold value. Under either circumstance insurance is justified, since destruction of the property in question would subject the lessee to a real loss. Attention may also be called to so-called "ground rent insurance," which has for its purpose the protection of the owner of land under lease against the loss of ground rent arising out of the destruction or impairment by fire of the building located on the land.⁷

⁷ The following sample of ground rent form is reproduced from Robert P. Barbour's "Agent's Key to Fire Insurance," p. 245:

GROUND RENT FORM

\$1,363.64 on annual ground rent of \$75, issuing out of lot and ground about 38 foot front by about 105 foot deep and improved by frame building situate
 Agreed value of ground rent \$1,363.64.

It being understood and it is hereby agreed that if the security for the payment of the ground rents or annuities hereby insured or any of them shall be impaired or diminished by reason of the damage or destruction by fire of the buildings erected on the above-mentioned lots or any of them, and the owner of the leasehold estate therein shall fail to repair or rebuild the same within six months from the happening of the fire, this Company shall pay to the insured or legal representatives, within thirty days after demand, the sum or sums hereby insured on the ground rents issuing out of such lots together with the ground rent accrued to date of said payment, not exceeding one year. This Company shall have the right, however, if it shall so elect, to pay unto the insured or its legal representatives the value of such ground rents as agreed upon above together with the ground rent accrued to date of payment, not exceeding one year, and on such payment the insured or legal representatives shall convey to the Company such lot or lots of ground and the ground rents incident thereto, clear of all encumbrances, save the leasehold estate therein and the unpaid taxes thereon. Reserving, however, to the insured the right to receive and collect and by legal process to recover

Different degrees of coverage obtainable under rent and rental value insurance.—Different types of policies, varying according to the degree of protection offered the insured, exist in the field of rent and rental value insurance. At least five degrees of liability on the part of the company should be mentioned, viz.:

(1) Where liability is based on the rent or rental value “for the time it takes to rebuild or restore the building to a tenantable condition” and irrespective of “whether the building is rented or vacant.”

(2) Where the form contains the same time limit as above, the liability of the company, however, being limited to “the rent or rental value of only the occupied portions of the building.”

(3) Where liability is based “upon the full annual rent or rental value” and irrespective of “whether the building is rented or vacant.”

(4) Where liability is based “upon the full annual rent or rental value” but extends only to the rent or rental value of “the occupied portions of the building.”

(5) Where liability is restricted to “the actual loss of rent or rental value sustained for a certain definite period in the year.”

for own use all arrears of ground rent in excess of one year.

It is understood that this insurance shall not be affected or invalidated by any act or neglect of the owner or occupant of the abovementioned buildings, nor by any foreclosure or other proceedings or notice of sale relating thereto, nor by occupation of the premises for purposes more hazardous than are permitted by this policy, nor by the violation of any of the terms or conditions of this policy not affecting the fee simple interest.

Lightning Clause attached.

CHAPTER XVI ✓

THE RESERVE IN FIRE INSURANCE

The Reserve Defined.—The reserve in fire insurance has its origin in the fact that the insurer collects the whole premium in advance, whereas the protection can only be given as time elapses during the one, two or five-year policy period. It may be defined as that portion of the premium which the company has not yet had time to earn.

The nature and purpose of the reserve in fire insurance become apparent if we take into account the manner in which a company earns its premium. Thus let us suppose that a company issues an annual policy for a premium of \$120. This premium is payable in advance, and since the policy has a year to run it is clear that the company has not yet earned this sum, but will become entitled to it only in the proportion that the policy reaches its maturity. At the end of the first month one-twelfth of the term has elapsed, and the company can rightfully consider that part of the premium, or \$10, as earned. Eleven-twelfths of the premium, however, or \$110, must be considered unearned, since the company has not yet furnished protection for the eleven months remaining in the term. At the end of six months one-half of the premium, or \$60, is earned, and the other half unearned. It is not until the end of the twelfth month that the company has furnished the full year's insurance, and is, therefore, entitled to the full premium.

This unearned portion of the premium constitutes the reserve. It must be regarded as a sum held in trust by

the company for its policyholders. Although paid to it in advance the company cannot claim this sum as its own property. It belongs to the policyholders, and must be earned by the company before it can be used at will for its own purposes. The reserve may thus be defined as "the unearned premium"; or as the liability of the company to its policyholders for that portion of the premium already collected, but not yet earned.

Real Purpose of the Reserve.—The term "reinsurance reserve," so generally used in insurance terminology, is a misnomer, and does not convey a true idea of the purpose for which the reserve exists. Certainly an insurance company does not start in business with the idea of winding up its affairs and reinsuring its business in another company. And even where a company reinsures its business, it does not at all follow, as some have argued, that the reserve should contain only that sum which would be required to reinsure its old business. Innumerable instances of reinsurance contracts exist where one company assumed the business of another company, and was willing to take considerably less than the unearned premium as the price for carrying the policies to maturity. Vice versa, where the company, desiring to cease business, is known to have been careless in the underwriting of its risks at inadequate rates, the reinsuring company might demand much more than the unearned premium as the price for carrying the reinsured policies to the end of their term.

Whatever the reasons may be that are advanced for the existence of a reserve, and there have been many, it will be found upon examination that all are untenable except that which regards the reserve as consisting of a sum equal to the unearned portion of the company's premium income, to be held by it in trust for the exclusive benefit of the policyholders. In case a company becomes insolvent, the receiver or assignee will take this view of

the case, and will consider each policyholder a creditor for the unearned premium on his policy. Even in case the company reinsured its business in another company, it by no means follows that the policyholders must consent. They can decide to withdraw, and are entitled to the unearned premium on their policies. If the company chooses, it may decide to retire from business, and no objection can be raised provided the company makes a settlement with all its policyholders by returning to them the unearned portion of the premiums. In fact, with or without giving a reason, either party to the insurance contract may decide to cancel it, and in such a case the company must have on hand the unearned premium, because every fire insurance contract provides that "if this policy shall be canceled as hereinbefore provided, or become void or cease, the premium having been actually paid, the unearned portion shall be returned on surrender of this policy, or last renewal, this company retaining the customary short rate, except that when this policy is canceled by this company by giving notice, it shall retain only the pro rata premium."

Legislative and State Departmental Requirements for a Reserve.—From the foregoing it is evident that the maintenance by every company of a fund equal to the unearned premiums on all its policies in force should be a necessary requirement for its financial solvency. It is only natural, therefore, that the several states have enacted laws requiring the companies to maintain such a reserve, and making it the duty of the insurance commissioner to determine annually their financial condition. These laws are of the greatest importance, and upon their strict observance depends, very largely, the security of policyholders. The law of Pennsylvania with reference to the determination of the reserve and financial solvency of the companies resembles, in its general outline, the law of most other leading states, and is as follows:

In determining the liabilities upon its contracts of insurance of any insurance company other than life insurance, and the amount such company should hold as a reserve for reinsurance, he shall, for fire insurance companies, charge fifty per centum of the premiums written in their policies upon all unexpired risks that have one year, or less than one year, to run, and a pro rata of all premiums on risks having more than one year to run; on perpetual policies he shall charge the deposit received, less a surrender charge of not exceeding ten per centum thereof. For marine and inland risks he shall charge fifty per centum of the premium written in the policy upon yearly risks, and the full amount of the premium written in the policy upon all other marine and inland risks not terminated.

Using the Insurance Department of the State of New York as a basis, the forms on pages 221 and 222 indicate the general nature, exclusive of numerous details, of the financial report required of fire insurance companies. The financial importance of the reserve becomes apparent from a study of such reports for any considerable number of companies. Thus, with respect to four of the largest representative fire insurance companies reporting to the State of New York, the unearned premium reserve for 1918 exceeded \$61,000,000, as contrasted with \$21,700,000 of capital stock, \$47,500,000 of surplus, and \$151,000,000 of total admitted assets.

Ascertainment of the Reserve.—In its strictest sense, we have seen that the reserve of a fire insurance company should consist of the unearned portion of all premiums collected. But when it is remembered that policies vary in their term all the way from a short period to a period of five years, and even longer, and that more policies are written at one time of the year than at another, it is apparent that it would be a difficult task to examine indi-

THE RESERVE IN FIRE INSURANCE 221

ABSTRACT OF FINANCIAL REPORT FOR 1918

of

.....INSURANCE COMPANY

Total Income.....	\$33,701,318. 95
Ledger Assets, Dec. 31, 1917.....	45,414,165. 60

Total.....	\$79,115,484. 55
Total Disbursements.....	27,416,753. 58

Balance.....	\$51,698,730. 97
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Ledger Assets.....	\$51,698,730. 97
Non-Ledger Assets.....	839,464. 25

Gross Assets.....	\$52,538,195. 22
Non-admitted Assets.....	2,248,754. 48

Total Admitted Assets.....	\$50,289,440. 74
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Net unpaid losses and claims.....	\$ 3,431,654. 98
Unearned premiums (fire).....	22,392,183. 00
Unearned premiums (marine and inland).....	1,167,766. 00
Other liabilities.....	2,042,698. 16

Liabilities, except capital.....	\$29,034,302. 14
Capital.....	6,000,000. 00
Surplus.....	15,255,138. 60

Total.....	\$50,289,440. 74
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vidually the thousands of policies of a large company with a view to determining the unearned portion of the premium for each. For all practical purposes a short cut rule may be adopted for the approximate ascertainment of this unearned fund. The law of Pennsylvania, already quoted, and generally applied throughout the United States, furnishes such a rule. It provides that the insurance commissioner shall calculate the reserve

RECAPITULATION OF FIRE RISKS AND PREMIUMS

(Form of statement required by New York Insurance Department)
For the above-mentioned Company

Year written	Term	Amount covered	Gross premiums charged, less reinsurance	Fraction unearned	Premiums unearned
1918	One year or less...	\$1,547,104,002	\$15,102,258.00	1-2	\$7,551,129.00
1917	Two years.....	17,496,244	130,353.00	1-4	32,588.00
1918		9,892,619	74,686.00	3-4	56,015.00
1916	Three years.....	619,640,083	5,631,028.00	1-6	938,505.00
1917		712,000,352	6,481,551.00	1-2	3,240,776.00
1918		685,271,709	6,713,971.00	5-6	5,594,976.00
1915	Four years.....	3,067,317	27,981.00	1-8	3,498.00
1916		5,580,038	37,627.00	3-8	14,110.00
1917		3,380,293	27,208.00	5-8	17,005.00
1918		3,042,037	57,452.00	7-8	50,271.00
1914	Five years.....	132,249,527	1,600,280.00	1-10	160,028.00
1915		137,746,618	1,656,135.00	3-10	496,841.00
1916		143,641,647	1,723,611.00	1-2	861,806.00
1917		169,850,901	2,011,066.00	7-10	1,407,746.00
1918		159,352,201	2,058,642.00	9-10	1,852,778.00
	Over five years....	7,963,233	69,156.00	pro rata	35,961.00
	Advance premiums	11,117,592	78,150.00	100	78,150.00
	Totals.....	\$4,368,396,413	\$43,481,155.00		\$22,392,183.00

for unexpired fire risks by "charging fifty per centum of the premiums written in their policies upon all unexpired risks that have one year or less than one year to run, and a pro rata of all premiums on risks having more than one year to run."

This rule is only approximately correct in its application to actual conditions, since it is based on the assumption that the volume of the company's business is uniform throughout the year, i.e., that as many policies of a given term are written on the first day of the year as on the last, and that as many are written on June 30 as on July 1. If this assumption is granted, it follows that the average life of all policies written in a given year is six months, and that consequently six months of the premium is earned, while the balance is still unearned. If all the policies written by a company in a given year are one-year policies, our rule provides,

since all these policies are assumed to have been in force six months, that the company can consider one-half of the total premium income from these policies as earned, and that the other half still remains to be earned. This unearned half of the total premiums, however, which constitutes the reserve for that year on one-year policies, will be earned during the first half of the following year.

If policies are written for longer terms, such as two, three, four, and five years, the same principle is applied. Thus in the case of two-year policies the term under consideration extends over twenty-four months. It is assumed that in a given year as many two-year policies are written at the beginning of the year as at the end of the year. Consequently, all two-year policies written in that year are assumed to have been in force six months, and during the year in which the policies were written the company earns the premium in the proportion that six months bears to the total term of twenty-four months, or one-fourth. One-fourth of the premium is, therefore, considered earned during the year in which the two-year policies were written and three-fourths is still unearned, or in the reserve. At the end of the second year the policy is assumed to have been in existence eighteen months (six months during the first year and twelve months during the second year), and the company is now entitled to the premium in the proportion that eighteen months bears to the full term of twenty-four months, or three-fourths. One-fourth of the premium, however, (the balance for the remaining six months of the term) is still in the reserve, and will be considered as earned during the first half of the third year.

In the case of three-year policies the term covers thirty-six months, and all such policies are again assumed to be in force for six months during the year in which they are written. Applying the same method used in

the above illustration, the company earns during the year in which these policies are written that portion of the total premium represented by the ratio of six months to the term of thirty-six months, or one-sixth, while five-sixths still remains to be earned. At the end of the second year the company earns another twelve months of the premium or one-third of the total, and the premium is now one-half earned and one-half unearned. At the end of the third year the earned portion of the premium amounts to five-sixths and the reserve to one-sixth, and this remaining one-sixth is considered earned in the fourth year. In the case of four-year policies the company earns during the year in which the policies are written one-eighth of the total premium (six months out of forty-eight months) and seven-eighths is in the reserve. At the end of the second year the earned premium and the reserve amount respectively to three-eighths and five-eighths; at the end of the third year to five-eighths and three-eighths; at the end of the fourth year to seven-eighths and one-eighth; while during the fifth year the remaining one-eighth of the premium is considered earned. Similarly, in the case of five-year policies, one-tenth of the premium is earned during the first year and nine-tenths is in the reserve. In each succeeding year the company earns another one-fifth of the premium, and the reserve decreases correspondingly, until in the sixth year the premium becomes fully earned and the reserve exhausted.

In the case of perpetual policies, it is customary to charge as a reserve the entire premium deposited minus a surrender charge not exceeding 10 per cent thereof. With respect to their perpetual business, companies go on the assumption that the interest earned on the single deposit of premium will be equivalent to the premium charge for term insurance. In other words, the assump-

tion is that the entire initial deposit on a perpetual policy remains intact. For this reason it is only just that the reserve liability of the company should approximately equal the entire premium.

PORTION OF PREMIUM EARNED AND UNEARNED DURING VARIOUS YEARS

Term of Policy	First Year		Second Year		Third Year		Fourth Year		Fifth Year		Sixth Year	
	Earned	Reserve	Earned	Reserve	Earned	Reserve	Earned	Reserve	Earned	Reserve	Earned	Reserve
1 year.....	$\frac{1}{10}$	$\frac{1}{10}$	$\frac{2}{10}$	0	$\frac{3}{10}$	0	$\frac{4}{10}$	0	$\frac{5}{10}$	0	$\frac{6}{10}$	0
2 years.....	$\frac{1}{10}$	$\frac{1}{10}$	$\frac{2}{10}$	$\frac{1}{10}$	$\frac{3}{10}$	$\frac{1}{10}$	$\frac{4}{10}$	$\frac{1}{10}$	$\frac{5}{10}$	$\frac{1}{10}$	$\frac{6}{10}$	$\frac{1}{10}$
3 years.....	$\frac{1}{10}$	$\frac{1}{10}$	$\frac{2}{10}$	$\frac{2}{10}$	$\frac{3}{10}$	$\frac{2}{10}$	$\frac{4}{10}$	$\frac{2}{10}$	$\frac{5}{10}$	$\frac{2}{10}$	$\frac{6}{10}$	$\frac{2}{10}$
4 years.....	$\frac{1}{10}$	$\frac{1}{10}$	$\frac{2}{10}$	$\frac{3}{10}$	$\frac{3}{10}$	$\frac{3}{10}$	$\frac{4}{10}$	$\frac{3}{10}$	$\frac{5}{10}$	$\frac{3}{10}$	$\frac{6}{10}$	$\frac{3}{10}$
5 years.....	$\frac{1}{10}$	$\frac{1}{10}$	$\frac{2}{10}$	$\frac{4}{10}$	$\frac{3}{10}$	$\frac{4}{10}$	$\frac{4}{10}$	$\frac{4}{10}$	$\frac{5}{10}$	$\frac{4}{10}$	$\frac{6}{10}$	0

In applying the foregoing method of computing the reserve, let us assume that an insurance company begins business in the year 1919, and during the first three years receives the following premium income: During the first year \$50,000 of premiums from one-year policies, \$25,000 from three-year policies, and \$25,000 from five-year policies; during the second year \$100,000 from one-year policies, \$50,000 from three-year policies, and \$50,000 from five-year policies; and during the third year \$200,000 from one-year policies, \$150,000 from three-year policies, and \$100,000 from five-year policies. Assuming that all these policies continue in force and that there are no cancellations, what should be the reinsurance reserve of this company at the end of each year?

By consulting page 227 it will be seen that during the first year of its history this company, according to the rule adopted for reserve computations, earned one-half of its \$50,000 of premium income from one-year policies written during the year, one-sixth of its \$25,000 of income from three-year policies, and one-tenth of its \$25,000 of income from five-year policies, or a total of \$31,666.67. The reserve for the three types of policies amounted respectively to one-half, five-sixths, and nine-tenths of the premiums received, or a total of \$68,333.33.

In the year 1920 this company earns the remaining one-half (\$25,000) of the premiums received on the one-year policies written in 1919. It also earns two-sixths of the premiums received in 1919 from the three-year policies, and two-tenths of the premiums received in 1919 from the five-year policies, or a total of \$38,333.33. But the company also wrote new business during 1920, receiving \$100,000 from one-year policies, \$50,000 from three-year policies, and \$50,000 from five-year policies. Of these new premiums the company is again entitled to one-half as regards one-year policies (\$50,000), one-sixth as regards three-year policies (\$8,333.34), and one-tenth as regards five-year policies (\$5,000), or a total of \$63,333.34. In all, the company earned during 1920 on its new business of that year and on its policies of 1919, which were still in force, a total of \$101,666.67. As regards its three-year policies written in 1919, however, there remains unearned at the end of 1920 three-sixths of the premium (\$12,500), and as regards five-year policies seven-tenths of the premium (\$17,500), or a total of \$30,000. By applying the proper percentages to the 1920 business, it is found that the company must keep in the reserve \$136,666.66, or, in other words, the difference between the \$63,333.34 earned on the 1920 business and the total premium income of \$200,000 received. At

Year of valuation	Date when Policies were written	Term of Policy	Amount of Premiums received	Earned	Unearned (Reserve)
1919	1919	{ 1 year.....	\$50,000	(1) \$ 25,000.00	(1) \$ 25,000.00
		{ 3 year.....	25,000	(1) 4,166.67	(1) 20,833.33
		{ 5 year.....	25,000	(1) 2,500.00	(1) 22,500.00
		Total.....		\$31,666.67	\$68,333.33
1920	1919	{ 1 year.....	\$50,000	(1) \$25,000.00	
		{ 3 year.....	25,000	(1) 8,333.34	(1) 12,500.00
		{ 5 year.....	25,000	(1) 5,000.00	(1) 17,500.00
		Total.....		\$38,333.33	\$30,000.00
	1920	{ 1 year.....	\$100,000	(1) \$50,000.00	(1) \$50,000.00
		{ 3 year.....	50,000	(1) 8,333.34	(1) 41,666.66
		{ 5 year.....	50,000	(1) 5,000.00	(1) 45,000.00
		Total.....		\$63,333.34	\$136,666.66
		Total for the year.....		\$101,666.67	\$167,666.66
1921	1919	{ 1 year.....	\$50,000	(1) \$8,333.33	(1) \$4,166.67
		{ 3 year.....	25,000	(1) 5,000.00	(1) 12,500.00
		{ 5 year.....	25,000		
		Total.....		\$13,333.33	\$16,666.67
	1920	{ 1 year.....	\$100,000	(1) \$50,000.00	
		{ 3 year.....	50,000	(1) 16,666.66	(1) \$25,000.00
		{ 5 year.....	50,000	(1) 10,000.00	(1) 35,000.00
		Total.....		\$76,666.66	\$60,000.00
	1921	{ 1 year.....	\$200,000	(1) \$100,000.00	(1) \$100,000.00
		{ 3 year.....	150,000	(1) 25,000.00	(1) 125,000.00
		{ 5 year.....	100,000	(1) 10,000.00	(1) 90,000.00
		Total.....		\$135,000.00	\$315,000.00
		Total for the year.....		\$224,999.99	\$391,666.67

the end of the second year, therefore, the company has earned a total on all the policies in force of \$101,666.67, and must have in the reserve \$167,666.66.

In the third year of its business (1921) our hypothetical company must make a reserve allowance for three classes of policies. Its three- and five-year policies written in 1919 have not yet expired; and by prorating the premium we find that at the end of the year there still remains to be earned \$16,666.67 of the premiums

collected in 1919 on these policies. As regards the business written in 1920, the company by the end of 1921 has only earned one-half of the premiums from three-year policies and three-tenths of the premiums from five-year policies, thus leaving \$60,000 of premium income not yet earned. From its new business, yielding \$450,000 of premiums, the company earns only \$135,000 during the year in which the policies were written, and \$315,000 must be assigned to the unearned premium fund. In all, therefore, the reserve at the end of the third year amounts to \$391,666.67. If our illustration were extended to the fourth year, the reserve computation would be still more elaborate, because the company would then have to consider four classes of policies, viz., the three- and five-year policies of 1919, the three- and five-year policies of 1920, the one-, three-, and five-year policies of 1921, and all the policies of 1922. (See statement required by New York Insurance Department, p. 222.)

Computation of the Reserve by Months, Instead of Years.—While the foregoing rule of arriving at the unearned premium is fairly safe for practical purposes, and meets the demands of the law, it should be remembered that it is only based on a system of averages that does not always conform to real business conditions. Where a company's business is rapidly gaining, and more policies are written in the later months of the year than in the early months, it is apparent that the policies have not, on the average, run for six months, and the reserve will, therefore, not be sufficiently high. Vice versa, if the company's business is declining, the reserve, if computed on the assumption that all policies written in the year have run six months, will be more than sufficient.

For this reason, if a large company wishes to know at any time the exact status of matters, and whether its unearned premium liability is increasing or decreasing,

it is desirable to compute the unearned premium fund by months instead of years. In fact, numerous companies now follow this method for their private information. As in the case of one-year policies, the assumption is made that as much business is written during one part of a given month as in another, and that consequently all policies written during a month may be assumed to have been in existence fifteen days. If a one-year policy is written in January, the company considers fifteen days, or one twenty-fourth of the premium earned at the end of the month, the remaining twenty-three twenty-fourths belonging to the reserve, while on the 31st of December twenty-three twenty-fourths of the premium is earned, and one twenty-fourth unearned. If the policy is written in February, three twenty-fourths of the premium will be unearned by December 31st. Similarly, with respect to its three- and five-year policies written in January, the company will consider fifteen days of premium as earned at the end of the month, while on December 31st the reserve on the three-year policies will be forty-nine seventy-secondths of the premium, and on the five-year policies ninety-seven one hundredths and twentieths. The operation of the reserve on the monthly basis may be illustrated by the following tables: ¹

¹ See Ralph H. Blanchard: "Liability and Compensation Insurance," p. 266.

EARNED AND UNEARNED PREMIUM AT THE END OF EACH MONTH DURING THE TERM OF A ONE-YEAR
POLICY

Months	1st	2d	3d	4th	5th	6th	7th	8th	9th	10th	11th	12th
Earned	1/24	3/24	5/24	7/24	9/24	11/24	13/24	15/24	17/24	19/24	21/24	23/24
Unearned	23/24	21/24	19/24	17/24	15/24	13/24	11/24	9/24	7/24	5/24	3/24	1/24

EARNED AND UNEARNED PREMIUM AT THE END OF EACH MONTH DURING THE TERM OF A TWO-YEAR
POLICY

Months	1st	2d	3d	4th	5th	6th	7th	8th	9th	10th	11th	12th
Earned	1/48	3/48	5/48	7/48	9/48	11/48	13/48	15/48	17/48	19/48	21/48	23/48
Unearned	47/48	45/48	43/48	41/48	39/48	37/48	35/48	33/48	31/48	29/48	27/48	25/48

Months	13th	14th	15th	16th	17th	18th	19th	20th	21st	22d	23d	24th
Earned	25/48	27/48	29/48	31/48	33/48	35/48	37/48	39/48	41/48	43/48	45/48	47/48
Unearned	23/48	21/48	19/48	17/48	15/48	13/48	11/48	9/48	7/48	5/48	3/48	1/48

CHAPTER XVII

FIRE INSURANCE RATES

Importance of the Subject.—During 1920, 789 joint stock and mutual fire and marine companies and 137 reciprocals and Lloyd's collected net fire and marine premiums in the United States amounting to \$1,019,441,045. This figure, however, must be substantially increased by the inclusion of the premium income of numerous mutual concerns not appearing in our statistical records. If we assume net marine premiums, collected in the United States, to aggregate \$231,000,000 (the total for 1918 as ascertained by an elaborate investigation), total fire premiums collected in the United States may be stated as being well in excess of \$788,000,000.

The object of fire insurance is to distribute among all insured property owners of the community those losses through fire sustained by the comparatively few. Its cost must be regarded in the nature of a tax assessed against the many for the benefit of the unfortunate few. It is the task of fire insurance companies equitably to assess, collect, and distribute this tax, exceeding a total of three-fourths of a billion dollars. The task of the tax gatherer has always been an unpleasant one, and the work of properly assessing taxes has been one of the most difficult problems of Government. The fire tax is no exception to this rule. Against its assessors and collectors—the insurance companies—there has been directed for years a vast amount of unfriendly criticism. Just as with other taxes, there is a constant endeavor to lessen

L. H. Bright

the individual burden. So many factors, however, enter into the making of the fire rate and so little does the average property owner understand why he is charged a certain rate, that the subject of rate making has come to be regarded by the public as marked by inconsistencies and guess work. When many independent companies, coöperating in underwriters' associations which usually promulgate the rates, are seen to charge the same rate for the same class of risks, it is only natural, in view of the general ignorance on the subject, to hear the cry that the companies have formed a combine in restraint of trade. Should some company show contempt for established rates and depart widely from the same, one hears much about exorbitant rates and excessive profits.¹

Instances of flagrant departure from established rates, however, are the exception, and fail utterly to show how the vast business of fire insurance in the United States is actually conducted to-day. As Mr. A. F. Dean so ably states in his "Rationale of Fire Rates": "Competitive conditions of this kind are so rare that they have no appreciable effect upon the aggregate business of the country. They have about as much influence upon average results as a shooting scrape or street brawl might have on the loss ratio of the accident companies. Where a rate war extends to an entire state, it may determine the retirement of a weak company or two at the end of

¹ For a detailed discussion of the subject of rate making in fire insurance see, Robert Riegel: "Problems of Fire Insurance Rate Making," *Annals of the Amer. Academy of Pol. & Social Science*, Volume 70, pp. 199-219, and "Fire Insurance Rates" published in the *Quarterly Journal of Economics* for August, 1916; A. F. Dean: "Fire Rating as a Science" and "The Rational of Fire Rates"; Richard M. Bissell: "Rates and Hazards," published in the *Yale Insurance Lectures*; J. S. Glidden: "Analytic System for the Measurement of Relative Fire Hazard: An Explanation," 1916; F. C. Moore: "Fire Insurance and How to Build," containing a copy of "The Standard Universal Schedule for Rating Mercantile Risks."

the year; but, as a whole, it simply serves to increase the average cost ratio of the country by a small percentage. That these things should create the inference that fire rates are the result of pure conjecture is natural, but the inference is false. The fire rate is the farthest possible removed from guesswork. In point of equitable distribution, it puts to shame the taxes assessed by our municipalities, states, or even the National Government. As a system, it is more carefully thought out, more elaborate, more logical, and more just than any governmental system of taxation. As a tax, it is assessed so close to aggregate cost that for long periods the residuum of underwriting profit is hardly more than an ordinary brokerage."

Fundamental Factors Underlying Rate Making.—*Difference in hazard between classes of risks.*—Why rate-making in fire insurance should have attained this carefully thought out and logical character becomes clear when we reflect how numerous are the elements which make up the hazard to which insured property is subject. At least five main factors must be taken into account. Ordinary intelligence will recognize at once the difference between a cotton mill and a brick dwelling from the standpoint of fire hazard; and such distinctions exist between hundreds of different types of property.

Difference in hazard between individual risks of the same class.—Taking two risks within the same class, let us say two cotton mills, one may be of inferior construction, a perfect tinder-box without any of the modern devices for preventing and extinguishing fires; the other of good construction, with boilers and dangerous processes in separate buildings or compartments, and equipped with all the latest fire preventive appliances. To charge the same rate on both mills would be an act of the grossest injustice, and would be overcharging the owner

of the best mill for the benefit of the other. In other words, to treat different owners justly and to recognize merit, i.e., to charge "like rates to like hazards," fire insurance companies are obliged to distinguish not only between the numerous classes of property, but also between the individual risks of each class.

The exposure hazard.—To carry the illustration further, each building of a given class is surrounded by an environment peculiar to itself. One factory or store may be far removed from other dangerous risks; another may be situated in the very center of a congested conflagration district. One may be in a city with poor fire fighting facilities, while the other has the benefit of a first-class fire department. As a matter of fact, with reference to fire extinguishing apparatus, some rating schedules divide cities into as many as seven classes, according to the degree of efficiency. The most limited intelligence will at once perceive that a distinction must here be made if justice in rating is to be secured.

The occupancy hazard.—With reference to a particular type of building, there exist hundreds of possible hazards of occupancy, meaning by that term the use to which the building is devoted. Of several buildings of like construction, one may be used as a dry goods store, another as a hardware store, a third as a drug store, etc. The buildings may be alike in construction, environment, and every other particular, yet the danger of destruction by fire to these buildings is different, because of the different substances and processes which they contain and the different uses to which they are put. In fire insurance there is an inherent connection between the building and its contents. It has been truly said that "the causes of fire are almost infinite in number, because every substance and almost every process of labor, manufacture, or commerce is, under certain circumstances or in certain rela-

tions to other articles or processes, productive of danger from fire." Manifestly, in the interests of justice as between one property owner and another, a distinction must be made by fire insurance companies between all the various uses or "occupancies" of different buildings, although belonging to the same class. To be just in their premium charges, it is also essential for the companies to change their rates to meet changing business conditions. Rate-making in fire insurance does not present constant factors, and justice demands that the companies should recognize the frequent changes which occur in the methods of manufacturing, commerce, heating, lighting, etc., as well as in statutory enactments and in the management of property.

The element of time.—Companies must also be careful not to base rates upon the showing of one or a few years. The five or ten-year average must be kept in mind, since the annual loss ratio is by no means uniform from year to year. Favorable years must not be made the pretext for an immediate altering of rates, despite popular clamor. Instead, good and bad years must be averaged for rate making purposes over a sufficiently long period of time to enable the companies to accumulate, during years of light losses, the funds necessary to endure the shock of exceptionally heavy losses at other times.

Considerations like the above serve to show that fire rates are fundamentally different from rates in most other branches of insurance, and unless apportioned by *system* as contrasted with *chance*, are bound to produce endless friction between underwriters and the public. In life insurance the problem of fixing rates has been reduced to a mathematical science. During the last fifty years the rate of mortality for the general population has varied but little. Applicants who do not qualify according to a certain arbitrary standard are as a rule rejected, while

those who do qualify are generally insured without much difference in rates except for the age of the applicant. The difference in hazard between insurable risks in life insurance is relatively small, and the factors governing the law of mortality are almost constant. In fire insurance, however, as stated by Mr. F. C. Moore, "there are more than a hundred features of construction in a single building which should enter into the consideration of its rate, irrespective of nearly forty features of its city or environment, nearly forty more different features of fire appliances, to say nothing of more than a thousand possible hazards of occupancy." It is the duty of fire insurance companies to take all these factors into account, to classify them properly, and then to assess a rate on every individual property that will approximately measure the risk. This is, to say the least, a gigantic task, and since no man's memory is capable of remembering all these items, and no individual knowledge is sufficient to put a price on them all, the fire insurance business has recognized the necessity not only of conference through underwriters' associations, which makes possible the combining of the knowledge of many underwriters, but also of furnishing to the rate inspector a printed schedule which will serve as a guide to his memory and prevent mistakes and omissions.

Development of Rating Systems.—Fire insurance rates may be determined in three ways, namely, by personal judgment, by schedule, and by tabulated experience. Historically, the personal judgment method was the first to be generally used. Owing to its inherent defects this method was later displaced by schedule rating, the system now in general use. In recent years, considerable attention has been devoted to "experience rating." This method, however, is only in the formative stage and has not as yet been adopted for use in any section of the country.

Personal judgment rating.—When the fire hazard was less complex than now, personal judgment rating was the prevalent method and served its purpose well. Its operation is well described by Mr. Richard M. Bissell in his lecture on "Rates and Hazards."² He states: "By means of a more or less complete system of classification, companies ascertained in a rough way the average cost of many kinds of risks, and this information was put into the hands of their special agents or gradually absorbed by them in the course of their work. Formerly special agents did practically all of the work of making rates in company with local agents. When a town was to be rated, these average cost figures were used as basis or foundation rates. Usually towns were rated by committees of from two to five special agents who acted for all companies. No rule or regular method of procedure governed the making of rates under this system. The rates so made simply indicate the opinion or judgment of the rate makers. Little attempt was made to analyze the factors which determined the judgment of the committee as to each risk. Nevertheless, since that judgment was usually the result of the experience and observation of many years spent in such work, the rates made were in many cases quite satisfactory, and equitable to a moderate degree. No attempt was made to take account of minor differences, but all good features or defects of construction and exposure, and also all the hazards of occupancy and processes, were lumped together, and if, as a whole, to the mind of the raters, they were sufficient to appreciably differentiate the particular risk from the average risk of its class, a penalty was added to or an allowance was made from the average rate which experience had shown to be about adequate."

Under such a system it is apparent that personal judg-

² Yale Insurance Lectures, Volume 2, pp. 106-107.

ments might differ greatly, and that unlike rates might result in the case of similar risks. With the increasing complexity of modern construction of buildings, the introduction of numerous fire protection facilities, and the development of manufacturing and commercial processes, the shortcomings of this system became more and more apparent. Its greatest defect lay in the fact that a disgruntled policyholder could not be shown why his rate was higher than that of his neighbor on what appeared to be an identical property. In the absence of any system, outlining the numerous merits and defects of the property under consideration, refuge had to be taken by the rater in his expert ability to judge the rate, and such an argument generally did not prove convincing to the owner. Justice in rate making requires that all of the aforementioned changes should be considered properly. In consequence less and less reliance could be placed upon personal judgment in making rates, and the companies were obliged to depend more and more upon the use of especially prepared rating schedules.

Schedule rating.—Numerous rating schedules are used in various states and cities of the country, but most of them, while differing greatly in details, resemble each other in their general purpose. In the case of certain groups of properties, where but few differences exist in the class, such as residences, schools, etc., the rate for the class is applied, and allowance made for the type of construction and the presence or absence of efficient fire protection. On the other hand, in the case of "special hazards," such as manufacturing risks, mills, elevators, warehouses, etc., special schedules are used. These, generally speaking, describe a building which is "standard" as regards construction, arrangement of processes, and fire extinguishing facilities. For such a standard risk a basis rate is then adopted, which, in the judgment of expert raters, measures

the various factors pertaining to the hazard involved. To this basis rate certain stipulated charges are next made for defects in construction, arrangement, and fire protection facilities, as compared with the defined standard building. On the other hand, certain deductions are made for unusually good features as compared with the standard. Deductions or charges are made also for the presence or absence of exposure hazard, coinsurance, faulty management, and other features. A large number of such special schedules exists, many of which are very intricate and detailed. In most instances expert service, usually given by men acting for a group of companies, is necessary for their application.

In the rating of manufacturing and mercantile properties a large variety of schedules is used, varying from the simple in small towns to the elaborate in large cities. According to the average schedule, cities and towns are divided into classes according to the degree of fire protection afforded. Next two basis rates are adopted in each town—one for brick and the other for frame construction—each measuring the hazard for an assumed type of building in each class. In the brick schedule, for example, additions are then made for defects of construction and exposure hazard, and deductions allowed for good features. To the rate as determined up to this point, called the “unoccupied building rate,” an addition is made to measure the hazard of the occupancy connected with the building. The contents of the building, on the other hand, are generally rated by making an addition to the building rate as outlined in the schedule, the charge depending upon the amount assigned to the particular commodity, or to the particular group of contents within which the commodity falls, according to some classified “occupancy table.”

Experience rating.—While schedule rating represents an improvement over personal judgment rating, it is important

to bear in mind that this method is nevertheless based essentially upon judgment, i.e., upon composite judgment as distinguished from the judgment of one or a few individuals. Most rating schedules of to-day represent, in their preparation, the combined judgment of a large number of individuals. They, therefore, reflect a reasonably accurate treatment of the various elements entering into the measurement of the fire hazard. Yet it is argued that they represent opinions instead of conclusions based on actual statistical evidence. Accordingly, attempts have already been made, which will be referred to later, to devise a rating system which will base rates upon tabulated experience.

Classification statistics, bearing upon fire loss and the reasonableness of rates, were difficult to obtain until recently. This was due to the facts that the companies' classifications were not always alike, and that various state authorities could require statistics according to different classifications, even assuming that the companies agreed upon a uniform plan. Through conferences between state authorities and representatives of the companies a uniform classification was agreed upon whereby the companies made their reports of experience to their own actuarial bureau. As a Special Committee on Fire Waste and Insurance of the United States Chamber of Commerce recently reported: "If rates charged for the service are too low, the solvency of the insurers is affected and the interests of the public are accordingly placed in jeopardy. If the rates are too high, relatively or absolutely, the individual has most valid grounds for objection. Such determination of these questions as is possible turns largely upon past experience, and it necessarily follows that statistics play a great part in the conduct and regulation of fire insurance. Compilation of such statistics of experience makes it possible for premiums in the various classes to

have a relation to fire losses in such classes. Your Committee believes that premiums should have such a relation."

Services Rendered by Schedule Rating.—Although subject to improvement, schedule rating is clearly superior to the method of judgment rating that preceded it. Moreover, it is the system now in general use, and its advantages should, therefore, be noted. Briefly described, they are:

Gives systematic treatment of the numerous features which differentiate one risk from another.—Schedule rating is designed to make fire insurance rates accurate and equitable, and to enable the property owner to see how his rate is made in every case, and thus allay the suspicion of unfair treatment which has been so prevalent in the past, and which has led to endless friction between insurer and insured. Much of the unwise state legislation is traceable to the failure of the public to understand the difficulties of equitable rating. "They reason," as Mr. Dean writes, "that when a number of competing corporations charge the same price for the same thing, it is a self-evident conspiracy in restraint of trade; in other words, a trust. The thing appears to be crooked when it is mathematically straight, and without the slightest effort to learn the truth, tariff and rating associations are declared unlawful under severe penalties."

Tends to reduce the fire waste.—Quite as important as the elimination of opposition of policyholders and legislatures to insurance companies, is the necessity of reducing the fire waste. Every one concedes that it is to the field of fire prevention that activity should be largely directed. Schedule rating is admirably adapted to accomplish much in this direction, if only property owners and legislators will acquaint themselves with the substance and purpose of the leading schedules in use. As Mr. F. C. Moore states: "It encourages proper construction of buildings by intelligently charging for deficiencies from standards, and by

recognizing exceptionally good construction by deductions. The architect, builder, and property owner, informed at the outset as to what can be saved by proper construction, will be led to avoid many of the faults now prevailing." Again, as recently pointed out by the Special Committee on Fire Waste and Insurance of the United States Chamber of Commerce:

"It lies within the power of the individual to obtain the benefits of schedule rating to which he is entitled. As a matter of legal right he can get a copy of the survey of his property. He can also obtain a statement of the elements which enter into the rate of insurance he pays—i.e., the base rate with the additions because of defects in the property and with the deductions on account of credit for improvements. The Committee recommends that, whenever he makes improvements in his property which eliminate any of the defects by reason of which the rate he pays is increased, he should at once request a reinspection of his property and an adjustment of rates in accordance with its improved condition from the point of view of the hazard of fire.

Schedule rating confers another advantage. When planning a building the owner can obtain an estimate for the rates of insurance he will pay, on account of each feature he incorporates or omits in the structure, and can calculate the return to him through savings on premiums by reason of investments in improvements and fire cut-offs that will reduce the hazard. The Committee recommends that persons planning buildings, or improvements, should submit them to the proper rating authorities for advice."

Secures more thorough inspection and rating.—Schedule rating gives the further advantages of making inspections more thorough and of discouraging the payment of excessive commissions for the writing of "preferred" risks. It is apparent that schedule rating will serve as a check upon the judgment and memory of the inspector, and will pre-

vent important departures from the prescribed standards. On the other hand, a rating schedule reduces all risks, for rating purposes, to a common level, making them all equally desirable. The company is enabled to make as much profit in underwriting a poor risk at a high premium, as by insuring a good risk at a lower rate, thus removing the necessity of granting higher commissions for the procurement of preferred classes of risks. By making possible a full explanation of why a certain rate is charged, property owners can also be made to see the folly of accepting policies in companies which charge unscientific and inadequate premiums, thus in the long run preventing cut-throat competition.

Rate Classifications.—Before undertaking a discussion of the leading rate schedules in use, attention should be called to the terminology employed to indicate various classes of rates. Briefly stated, rates may be classified according to:

The subject-matter of the insurance.—Reference is had to “building” and “contents” rates, referring respectively to rates upon buildings and upon the contents they contain. In the main, the same principles underlie the determination of both kinds of rates. Moreover, as will be explained later, there is a very close relation between the building and its contents, and vice versa, as regards the fire hazard. Accordingly, when rating a building due allowance must be made for occupancy, and similarly when rating contents the nature of the building that houses the same must be considered.

The term of the policy.—Under this classification there are “annual,” “term,” and “short rates,” the first referring to the rate on a one-year policy, the second on a policy running longer than a year, and the last on policies that are written for less than a year or that are canceled before their regular maturity. In practice the companies

reduce the premium as the policy term becomes longer. Thus, as a general rule, on two-year policies the rate is only $1\frac{1}{2}$ or $1\frac{3}{4}$ times the annual rate; on three-year policies only 2 or $2\frac{1}{2}$ times, and on five-year policies only 3 or 4 times. The reasons for the reduction on longer term policies are (1) saving in expenses, (2) larger interest earnings owing to the longer time that the company holds the premium, and (3) possession of a larger reserve in the event of loss.

The type or location of risk.—This classification embraces “specific,” “blanket,” “average” and “minimum” rates. A specific rate is determined by schedule for an individual property. A blanket rate is one charged for a policy covering two or more risks of a similar character and situated in different locations. An average rate, on the contrary, is one that applies to the insurance of a number of risks, differing in their character, but situated in the same location. Minimum rates are those which are applied equally to every risk within a given group, such as dwellings, schools and churches.

Owing to the large number of risks that come under minimum rates (about one-half of the buildings in large cities), a brief explanation of this type of rate is in order. Dwellings as a class, for example, present so few differences in construction as to make the elimination of expense connected with schedule rating highly desirable. Accordingly, these rates are usually fixed by some committee of the local fire underwriters’ association, and may thus be regarded as judgment rates. They are published without reference to the factors that may have been considered in their determination. Although simple and inexpensive in application, minimum rate systems have been the subject of severe criticism. It is argued that they may easily lead to discrimination between the several groups of risks involved and other classes of property.

CHAPTER XVIII

SCHEDULE RATING IN FIRE INSURANCE

The Universal Mercantile Schedule.—Without attempting to trace all rating schedules that are now applied to special types of property, let us analyze the leading schedules of to-day, namely, the "Universal Mercantile Schedule" and the "Analytic System for the Measurement of Relative Fire Hazards," both of which are in general use, and the "Experience Grading and Rating Schedule" which is still in the formative stage. As its name implies, the Universal Mercantile Schedule was designed for the rating of mercantile and manufacturing risks, by far the most important class. It is the product of hundreds of eminent underwriters under the leadership of Mr. F. C. Moore and represents their united underwriting judgment. It was also the first comprehensive schedule to be devised, and, with certain modifications, is now used in a number of our largest Eastern cities.

Standards used by the Universal Mercantile Schedule.—The starting point in the fixing of a rate on a non-fireproof brick building under this schedule is the adoption of a standard—a standard building in a standard city—by which to judge other risks which may be poorer or better in quality. The standard city referred to under this schedule is of a high type, and is defined with reference to the character of the waterworks, the size of water mains, the quality of the fire and police departments, the width and surface of the streets, the presence of a good building law, the absence of dangerous outlying exposures, and a

previous five-year record not exceeding \$5 annual fire loss per \$1,000 of insurance. A standard building is defined with reference to construction and thickness of walls, area, height, floors, windows, beams, walls and doors.

The "basis rate."—For a standard building as defined and situated in a standard city, the schedule fixes a rate of 25 cents per \$100 of insurance, and this rate—the "basis rate"—is the starting point in the computation of all rates. If the building or city under consideration does not measure up to the standard adopted, the actual rate is found by adding certain charges to this 25 cent basis rate for any defects, or by deducting certain charges from this rate for exceptionally good features. In framing the schedule the committee which undertook the work aimed "to secure a rate on which the fire cost of the past five years per \$100 of insurance would result in such percentage of the premium as, with an allowance for proper expenses, and, also, for accumulation for periodical and inevitable sweeping fires or conflagrations, would leave a margin for a moderate profit not exceeding five per cent."

The "key rate."—The basis rate being fixed at 25 cents, the first step in the process of rate making is to determine the rate on a standard building in the given city. This is done by adding charges to the 25 cent rate for special hazards of the city in which the property is located. Thus, to illustrate, if the town has no fire department, an addition of 32 cents is made to the 25 cent rate. If there is no building law, the extra charge for this item is 3 cents; while if there is danger of sweeping fires from outlying exposures, such as extensive lumber districts, the charge is 5 cents. In all, some thirty-one deficiencies of the city were originally provided for in the schedule. Deductions from the original 25 cent rate are permitted, however, for certain exceptionally good features of the city. After all such additions and deductions have been made, the result

is the basis rate for a standard building in the given city. This rate, known as the "key rate," is then used as the starting point for rating all buildings in the city under consideration.

Additions or deductions for variations from the standard building.—But most buildings will not measure up to the standard building and further additions must, therefore, be made to the "key rate" for any deficiencies which may be found. (For a copy of the Universal Mercantile Schedule for non-fireproof buildings, see p. 259.) Owing to the high type of building adopted as a standard, the number of additions for defects is exceptionally large. Numerous charges are made for defects, compared with the standard building, as regards walls, roof, floors, area, height, stairways, skylights, lighting, heating, chimneys, street, etc. From the rate thus obtained, deductions are next made for exceptional features in the construction of the building.

Addition to cover the occupancy hazard.—The rate as it now stands is for the "building unoccupied"—that is to say, no allowance has been made for the contents of the building or the particular use to which the building is put. But we have seen that there is an inherent connection, as regards the fire hazard, between the building and the contents it contains or the use to which it is devoted. Consequently we must add something to the building rate as it now stands to allow for this factor. If the building is a retail drug store, the rate as determined up to this point is increased by 10 cents, but if it is used as a cotton gin by 350 cents. Charges for hundreds of different occupancies are provided by the schedule. (For a copy of sample page of the "Occupancy Table," see p. 272.) After the proper charge has been added for the "occupancy," the result is the "rate of the building occupied."

Addition to cover the exposure hazard.—From the rate

of the building as now determined, deductions are next made for nearness to hydrants and for the presence, if any, of special private fire appliances, such as internal stand-pipes, an auxiliary private fire plant, an automatic fire alarm system, etc. The result is the "*rate of the building occupied, but unexposed.*" We saw, however, that a very important factor in rate making is the environment surrounding the building, and the company must next add a charge for this factor according to the hazard. From the total rate thus obtained, a very liberal deduction is made for the presence of automatic sprinklers, varying according to the sprinkler system used. The result represents the "*rate for the building occupied and exposed.*" It now only remains to add to this rate for the absence of co-insurance, the existence of various types of adverse legislation, and the presence of serious faults of management, in order to have the final rate on the building.

Rating stock within the building.—In rating contents within the building the starting point in the Universal Schedule is the rate of the "building occupied." From this rate there is deducted a sum equal to one-fourth (or some other fraction in certain cities) of the deficiencies of the building, i.e., one-fourth of the excess of the rate of the building unoccupied, as compared with the basis rate of 25 cents. According to the schedule, "this computation is necessary to adjust the difference in rate between a building and its stock. Obviously, the difference between the two should be greater in proportion as the building is of substantial construction; in other words, the better the building the greater should be the difference between its rate and that of its stock, which is more susceptible to damage, and the poorer the building the less should be the difference, for a building of weak construction is almost as certain to be totally destroyed as the stock contained in it. Clearly, the amount added to the key rate (the rate

for a standard building) for variations of the building from standard construction is the proper guide for determining the relative weakness of the building, and, therefore, whether more or less should be added to the building rate to obtain its stock rate." Hence the rate of the building occupied, minus one-fourth, or some other fraction, of the deficiencies of the building, the amount determined upon by the framers of the schedule, is considered the "key rate" for stock within the building.

To this key rate there is next added the figure in the second column of the occupancy table. All stocks are arranged alphabetically in a table of two columns, the figures in the first column measuring those features of the stock which will cause fires, and the second column containing those figures which measure the susceptibility of the stock to damage by water, smoke, heat, etc. It is clear that many occupancies are much more apt to be the cause of severe fires, and should, therefore, materially increase the rate of the building in which they are located. On the other hand, there are many stocks, such as hardware and the like, which, while not hazardous as a cause of fire, are nevertheless peculiarly subject to damage by water or smoke, although the fire may never reach large proportions. Following this addition to the "key rate," in order to allow for the susceptibility of the stock to damage from the resultant effects of fire, the method pursued in arriving at the final rate of the stock is very similar to that already explained in connection with the rating of the building.

The Analytic System.—The "Analytic System for the Measurement of Relative Fire Hazard," or the Dean Schedule as it is commonly called, differs from the Universal Mercantile Schedule in many important particulars. While affording the advantages of schedule rating, it is based upon principles radically different from those used in making the Universal Mercantile Schedule. Owing to its gen-

eral use in the Middle West, it will be our object to point out briefly the essential differences between the two schedules, as illustrated by that portion of the Analytic Schedule devoted to the rating of brick buildings.

Ordinary type of building selected as a standard.—The Analytic Schedule does not attempt to prescribe a basis rate for a standard building in a standard city, but instead, cities and towns are divided into seven classes, varying all the way from those without any fire protection to those with excellent facilities along this line. Then, instead of adopting a "standard building" of ideal construction, the schedule uses as a starting point a one-story brick building of ordinary construction, situated in a town of the lowest class. Underwriters, it is argued, are familiar with this ordinary type of building, and are relieved of the necessity of making the large number of additions for defects required by the Universal Mercantile Schedule, which, as we have seen, assumes as a starting point a standard building much superior in character to the average building.

Optional selection of a basis rate.—Unlike the Universal Mercantile Schedule the Analytic Schedule also allows latitude in naming the basis rate, the underwriters in each locality being allowed to select that basis rate which is best applicable to the community in question. It is argued that underwriters are best able to judge the basis rate that should be applied to their respective districts. To enable underwriters in various localities to select a proper basis rate, the schedule furnishes a number of tables indicated by the titles "60 cents," "65 cents," "70 cents," "75 cents," etc., up to "120 cents," these figures representing the basis rate for a one-story building in a town of the sixth class. The schedule leaves it to the raters of the various districts to choose the table which they regard best suited to local conditions; but having selected one of the tables (i.e., having chosen a basis rate), it is recommended

that the same be strictly adhered to in other particulars. (For comparative illustrations of the 60-cent, 80-cent, and 100-cent basis tables, see p. 273.)

60 CENTS

Height	Class 1	Class 2	Class 3	Class 4	Class 4½	Class 5	Class 6
1 story.....	.33	.37	.42	.47	.52	.57	.60
2 story.....	.34	.39	.44	.49	.54	.59	.63
3 story.....	.36	.40	.46	.52	.57	.62	.66
4 story.....	.38	.43	.49	.55	.61	.66	.70
5 story.....	.41	.47	.53				
6 story.....	.46						
Increase for each additional story....	.07	.07	.07	.07	.07	.07	.07
Decrease if no basement.....	.02	.02	.02	.02	.03	.03	.03

In case the underwriter wishes to rate a three-story brick building in a city of the second class, and has decided to adopt the 60-cent basis table, it is only necessary in order to arrive at the basis rate for the building to glance at the column entitled "Class 2," and opposite the line entitled "3 story" there will be found the figure 40 cents, which represents the basis rate for the risk under consideration. On the other hand, if, owing to local conditions, the rater decides to select the 100-cent table, he will consult that table, pursuing the same method used in the previous case, and will find the figure 67 cents as the basis rate to be adopted.

Additions and deductions for bad and good features in percentages.—Having determined the basis rate, the rater must next make additions and deductions which measure the deficiencies or good qualities of the building in question. In making such additions, however, the Analytic Schedule uses percentages in all cases, while the Universal Mercantile Schedule, as we saw, provides for the addition of absolute amounts, such as 5 cents, 10 cents, etc. The Analytic method aims to maintain relativity in charges and credits, because, as Mr. Dean explains, certain features, such as an open elevator shaft, etc., are much more dangerous in

tall buildings of large size than in low ones of moderate area. If the addition for a defective elevator shaft, for example, is measured by an absolute amount, say, 12 cents, in the case of all buildings, it is argued that this charge will be twice as large relatively for a building whose basis rate is 50 cents, as for one whose basis rate is 100 cents. As a matter of fact, the situation should be reversed, and this, it is claimed, can only be done by making the addition in percentages, in which case the charge for the defect will be greater in the building rated at 100 cents than in the building rated at 50 cents. (For a sample calculation of a building rate see page 274.)

Occupancy table classified under "cause," "media" and "effect."—Having entered on the rating sheet the basis rate, and all charges and credits connected with the building, the next step is to refer to the classified list of occupancies, and enter the charges for occupancy found in columns 1 and 2. (For a sample section of the Alphabetical Occupancy Table, see p. 275.) This table of occupancies differs very materially in form from the occupancy table found in the Universal Mercantile Schedule. The table consists of three columns, a brief typical section of which is herewith given:

Occupancy	Cause	Media	Effect
100a ACADEMIES in Mercantile Buildings...	10%	....	D2
b Techinical Schools with apparatus...	10%	....	D3
c Manual Training with woodwork..	20%	....	D3
101 ADVERTISING Novelties, etc.....	10%	20%	D3

A few words of explanation are necessary to show the application of this table as compared with the Universal Mercantile Schedule. As will be observed, the Analytic Schedule divides the occupancy table into three columns,

under the headings of (1) Cause, (2) Media, and (3) Effect. In the first of these columns is found the percentage of the basis rate to be added to the building rate for the particular occupancy because of its tendency to cause a fire. In the second column is found the percentage charge of the basis rate which represents the combustibility of the stock, that is to say, the extent to which goods will contribute to the spread of a fire. The third column indicates the grade of the article (the grades being represented by D1, D2, D3, D4, and D5) with reference to its "damageability," that is to say, the extent to which the goods are likely to be injured by the effects of fire, such as smoke, water, heat, breakage, etc. This classification of occupancies, it will be observed, is very elaborate. As regards "cause," it is apparent that some occupancies are much more dangerous than others, some, according to the schedule, being "inert," like banks, offices, studios, etc., while others are "active." Again, as regards the classification of "media," some occupancies involve merchandise of low combustibility, such as hardware, rubber goods, wool, and woolen goods; other occupancies involve merchandise which burns moderately, such as retail groceries, dry goods, and the like; other merchandise burns freely, such as straw goods, hay, millinery, etc.; other goods burn with great intensity, such as matches, saltpeter, celluloid goods, etc., but are not subject to spontaneous combustion or destruction, except through actual contact with fire; while still other grades of goods are of an extremely inflammable character, because they are liable to spontaneous combustion or burn with an intensity amounting practically to an explosion.

The Analytic Schedule also classifies elaborately the "effect" or damageability of various classes of merchandise. Merchandise, represented by the insignia "D1," in the table of occupancies, includes articles, such as leather goods,

etc., which are largely immune from damage from the indirect effects of fire, such as water, smoke, and heat; "D2" represents articles, such as retail groceries, dry goods, etc., which are but moderately affected; "D3" relates to merchandise, such as paper, butter, fruit, books, etc., which are easily damaged; "D4" refers to merchandise, such as millinery, florists' stocks, contents of cold-storage warehouses, etc., which are liable to heavy damage from slight effects resulting from fire; while "D5" consists of mixed stocks of goods, such as those contained in department stores and general storage warehouses, which require a personal estimate to ascertain the average damageability.

Having added to the building rate the charges for occupancy found in columns 1 and 2 of the occupancy table, the difference between the total of the debit and credit columns in the rating sheet shows the percentage of the basis rate, which is to be added to it in order to obtain the "occupied rate of the building."

Contents tables.—To get the rate on the contents within the building, reference must be made to the "contents tables" of the schedule, with a view to adding to the occupied building rate the amount indicated by the insignia D1, D2, D3, etc., as the case may be, according to the grade of protection for the town and the location of the contents in the building. (For sample illustration of a contents table, see p. 276.) The contents tables are very ingeniously devised, being so arranged that they take into account (1) the basis rate used in rating the building; (2) the class of city according to the type of fire protection; (3) the location of the contents, whether in the basement, or on the ground floor, second floor, etc.; and (4) the nature of the contents to be rated, whether belonging to class D1, D2, etc. Numerous tables are devised embodying the foregoing features, so that the rater need only look up the proper table with a view to finding the amount to be added to the

occupied building rate, in order to determine the rate on the contents.

Treatment of the exposure hazard.—One of the most important features of the Analytic Schedule is the so-called "exposure formula." This has received much attention from underwriters, and has been commended very highly. The treatment of the exposure hazard is very detailed, and merely the general outline can here be presented. External exposures are classified under three heads, namely: "(a) Radiated Exposure, consisting of the proportion of its own hazard a risk radiates toward exposed risks; (b) Absorbed Exposure, consisting of the proportion of the radiated hazard absorbed by an exposed risk; and (c) Transmitted Exposure, or the proportion of the hazard a risk absorbs from one side, and which is transmitted by it to a risk on the other side."

In connection with the above classification Mr. Dean points out: "(1) That every exposing risk radiates some ratio of its own hazard toward exposed risks; (2) that every exposed risk absorbs some ratio of this radiated exposure; (3) that every risk transmits some ratio of the hazard it absorbs; and (4) that radiated, absorbed, and transmitted exposure is modified by structure, clear space, and fire department protection." Mr. Dean next submits elaborate tables of alternative standards, with recommendations as to their application in the case of different classes of property, with reference to the clear space between the exposing and exposed buildings, and the grade of municipal fire protection.

The Experience Grading and Rating Schedule.¹—Both the Universal and Analytic Schedules, as previously noted,

¹For a detailed explanation of this schedule, see Dr. Robert Biegel's article on "Problems of Fire Insurance Rate Making," *Annals of the Amer. Academy of Political and Social Science*, Volume 70, 1917.

are judgment systems, and are not based upon actual statistical evidence. Although representing a great improvement over previous methods, they are open to attack on the score that rates on different classes of risks should be in accord with actual experience, whereas the existing systems merely base the charges or deductions for defects or good features upon underwriting judgment. Policyholders and legislators have become increasingly insistent in their demand that rates on the various classes of property should have a close relation to the actual fire losses experienced in such classes.

To meet this demand Mr. E. G. Richards devised a system, known as the Experience Grading and Rating Schedule, or the "E. G. R. Schedule," which has for its purpose the determination of rates on the basis of actual tabulated experience. The task of doing this, it will be recognized, is gigantic, and space limits forbid more than a very general outline of the proposition. Briefly stated, the plan involves "the provision of an 'insurance written' and a 'loss' card for every risk, showing the state and the city or town in which located, the occupancy class in which the risk falls, the amount written, the term of the contract, the expiration, the grade of building, the grade of occupancy, the grade of internal exposure and external exposure, etc."² With the actual experience thus recorded on cards for all insured risks and losses in the country, it will then become possible, through the use of modern tabulating machines, to sort out any combination of cards with respect to any set of circumstances.

Without attempting a presentation of the many classifications undertaken in the E. G. R. Schedule, it should be stated that the schedule emphasizes three principal features

² Robert Riegel: "The Problems of Fire Insurance Rate Making," p. 213.

in the classification of experience for the determination of a rate, namely, *the inherent hazard*, which represents "the danger of loss due to inherent qualities of an occupancy after making proper allowance for the character of the building"; *internal exposure* which relates to "the danger of loss due to the presence in the building of occupancies other than the risk under consideration"; and *external exposure* which refers to "the danger of loss by reason of surrounding hazards outside the building of the risk in question."³ The total hazard comprises the sum of the three hazards as just outlined. The plan also undertakes "(1) to ascertain the ratio of losses, expenses and a fair profit to the insurance written on all risks in the United States, (2) to obtain a similar ratio for the average risk in each particular state, (3) to ascertain the average United States' rate on a risk of a specific class."⁴ With all this statistical experience at hand, the general method of procedure is explained by Dr. Riegel with the following illustration:

"Thus an inherent loss cost of 87 cents, an internal exposure cost of 35 cents and an external exposure cost of 23 cents compose the total loss cost of the risk, \$1.45 per \$100 of insurance.

But such cannot be the rate on the risk for it would make no provision for expenses or profit. A study of expense statistics leads the schedule's author to the conclusion that expenses are about $41\frac{1}{2}$ per cent of all costs; therefore the loss cost, \$1.45, must be $58\frac{1}{2}$ per cent of the total cost. On this basis \$1.02 would have to be added to the loss cost for expenses, giving \$2.47 as the total cost. Add-

³ The above definitions of inherent hazard, internal exposure, and external exposure are those of Dr. Riegel in his article on "The Problems of Fire Insurance Rate Making."

⁴ Robert Riegel: "The Problems of Fire Insurance Rate Making," p. 214.

ing to this 5 per cent of itself, or 12 cents for profit, the final rate is \$2.59 for a risk of this particular nature in the *United States*.

But losses and expenses on risks vary with the state in which a risk is situated. One of the complaints against other systems of rating, as was noted, was the failure to give sufficient consideration to the loss record of the state. It is necessary to proportion this rate of \$2.59 to the loss record of the state in which the risk is situated, which we may assume to be New York. The average rate of premium for all risks in the United States is found, by reference to statistics which are available of stock companies' underwriting experience, to be 112.5 cents, this figure including expense and 5 per cent profit. The average rate of premium for all risks in New York is found to be 75.1 cents.⁵ The risk in New York should pay only about $\frac{75.1}{112.5}$ of the average rate of a particular class of risk in the United States. For a risk of the kind for which figures have been assumed here, situated in New York state, the rate would, therefore, be $\frac{75.1}{112.5}$ of \$2.59, or \$1.73 per \$100 of insurance."

⁵ "In arriving at the average rate for a state unusual conflagration losses are apportioned among all states. California's loss cost would be 2.327 if it bore the total conflagration loss itself, but is considered as only .716 per cent after the conflagration loss is distributed among all the states."

COPY OF THE UNIVERSAL MERCANTILE SCHEDULE FOR
NON-FIREPROOF BUILDINGS

RATING SLIP.—NON-FIREPROOF BUILDINGS.

Survey No..... Inspected by.....
Date.....19....

UNIVERSAL MERCANTILE SCHEDULE.

Risk.....No.....Street
Stock of.....in.....Story.....Bldg.
Ins. Map, page.....Block.....City of.....

DEFICIENCIES

N. B.—For full explanation refer, by No. of item, to the
Schedule

No. Charge

KEY-RATE OF CITY (See page 13.)

WALLS—INDEPENDENT (for Party see No. 40)

38 Charge for EACH 4 INCHES deficiency in
average from standard (if bldg. over 4 stories
high, double the charge)02

39 On buildings over 3 stories high if average
thickness less than 12 inches, add (in addition
to No. 38) not less than08

If two independent walls adjoin, 4 inches may be
deducted from average of these requirements. Charge
for one wall only—the most deficient.

A STANDARD INDEPENDENT WALL (p. 11) should be
12 inches at the top story and increase 4 inches for
each story to the bottom. This would require if 3
stories, an average of 16 inches; if 4 stories, 18 inches;
5 stories, 20 inches; 6 stories, 22 inches; 7 stories,
24 inches.

40 PARTY WALL—Charge for EACH INCH defi-
ciency in average from standard (if bldg. over
4 stories high double the charge).....01

41 If party wall less than 12 inches thick in any
portion, add (in addition to No. 40) not less
than.....10

A STANDARD PARTY WALL should be 16 inches at
the top story, increasing 4 inches for each story below.
Average required for 3 story bldg., 20 inches; 4 story,
22 inches; 5 story, 24 inches; 6 story, 26 inches;
7 story, 28 inches, etc.

42 WALLS NOT PARAPET, each exposed side. .05

43 POOR BRICKS or poor quality mortar.... .20

44 IRON FRONTS, for each not backed up with
bricks and mortar......05

45 IRON FRONTS, for each backed up.....02

46 “ “ for each adjoining in row, in
addition to above.....02

UNIVERSAL MERCANTILE SCHEDULE—Continued

	No.	Charge
ROOF—47 Composition and gravel.....	.01	
48 Slate.....	.02	
49 Shingle.....	.15	
50 MANSARD with wooden frame, 4 story or lower bldg., one side.....	.15	
Each additional side.....	.05	
51 “ on building 5 stories or more in height, one side.....	.20	
Each additional side.....	.10	
ROOF SPACE, BLIND ATTIC, COCK-LOFT, ETC.—52 Take maximum height if slanting roof, and add for each vertical foot .03, not exceeding a total of.....	.10	
FLOORS—53 Double flooring less than 3 inches thick, or single 2-inch flooring, add.....	.03	
54 Single flooring less than 2 inches.....	.05	
55 FLOOR BEAMS OR JOISTS less than 3×10 inches.....	.03	
CEILING OR SHEATHING—56 Wood or straw- board CEILING, one story.....	.05	
each additional story.....	.03	
57 Wood or strawboard SIDING, one story... each additional story.....	.05 .03	
If side walls FURRED and plastered, half charge for wood sheathing.		
57a Cloth or paper ceiling or siding on wooden studs, each story.....	.10	
AREA— (Ground floor)..... ft. X..... ft. Total..... sq. ft.		
58 2,500 sq. ft. to 5,000 charge for each 1,000 in excess of 2,500 sq. ft..	.01	
59 5,000. “ “ 10,000, 3 stories, in excess of 2,500 sq. ft.....	.02	
5,000. “ “ 10,000, over 3 stories, in excess of 2,500 sq. ft.....	.03	
60 10,000. “ “ or more, 3 stories, in excess of 2,500 sq. ft.....	.025	
61 10,000. “ “ or more over 3 stories not over 6 in excess of 2,500 sq. ft.....	.05	
(Not exceeding a total of 200 cents.)		
62 10,000 sq. ft. and over 6 stories, double the area charge. (Not exceeding a total of 300 cents.)		
AREA 62—FORWARD (OVER)		

UNIVERSAL MERCANTILE SCHEDULE—*Continued*

	No.	Charge
AREA 62—BROUGHT FORWARD		
If building is of standard fire-resisting construction throughout, halve the area charge.		
ONE-STORY BUILDING , one-half the charge for 3 story.		
TWO-STORY BUILDING , two-thirds the charge for three-story.		
If CURTAIN, CROSS OR DIVISION WALLS , sub-dividing and <i>Strengthening</i> the building, even though with arched openings, deduct 10% of area charge for each wall so dividing the risk, not exceeding a total deduction of 40% of the area charge. Communications with adjoining buildings unprotected, charge for area both buildings, and rate as one (allowing for division wall.) If fire doors on communications are not standard, rate as if standard and make an additional charge under "Exposures" for defective doors.		
SINGLE OCCUPANCY —If only one tenant (outside of dwelling and office tenants) twenty per cent. (20%) of the area charge may be deducted.		
HEIGHT—(.....Stories) 63 For fifth story, add.....		.05
64 Sixth story . . . . .		.10
65 Seventh story . . . . .		.25
66 For each story over seven, add.....		.40
These charges cumulative; for example, a seven-story building would have 40 cts. added.		
If any story double height, charge for two.		
STANDARD BUILDING may be seven stories without charge if in town whose key rate is not over 30 cts.		
66a Eighth story on standard building.....		.24
66b Ninth story on standard building.....		.40
ELEVATORS—67 Enclosed in lath and plaster shaft or hallway, or if provided with approved automatic trap doors . . . . .		.05
67a Fire-proof shaft, but defective doors, or walls not through roof . . . . .		.03
68 Open . . . . .		.12
69 Wooden shaft without approved automatic traps . . . . .		.15
70 One-half above charges for elevators in buildings otherwise standard, or in office buildings.		
If more than one elevator, charge for worst and add one-fourth charge for each additional.		
STAIRWAYS—71 Enclosed in lath and plaster hallway or provided with automatic trap-doors in floors . . . . .		.07
71a Similar to above with traps closed only at night . . . . .		.12
STAIRWAYS—FORWARD (OVER)		

UNIVERSAL MERCANTINE SCHEDULE—Continued

	No.	Charge
STAIRWAYS—BROUGHT FORWARD		
71b Fire-proof enclosure, but defective doors, etc.....	05	
72 Enclosed in wood with self-closing doors each floor.....	10	
73 Open.....	15	
If more than one stairway, charge for worst and add one-fourth charge for each additional.		
One-half charge for 71, 72 or 73 if charge for 67, 68 or 69—halve the smaller charge.		
If elevator and stairway are contained in the same shaft or opening, only one charge for the two.		
No charge for stairways in buildings occupied exclusively for offices and dwellings above first story when stairway does not open into store.		
WELL-HOLES—74 If open, add for each floor pierced (half charge for approved traps) .05		
CHUTES, DUMB-WAITERS, VENT, SHAFTS (unless fire-proof shaft), and small floor openings—75 Add for each, and for each floor pierced.....	02	
SKYLIGHTS—76 If of thin glass (less than $\frac{1}{2}$ inch), or if unprotected wooden frames, charge for each 9 sq. ft. in excess of 9 (not exceeding a total of 25 cts.).....	02	
If skylight is monitor style, charge for square feet in sides as well as top. If protected above and below with wire netting, or if $\frac{1}{4}$ inch glass, one-half charge.		
Same charges for floor-lights less than $\frac{1}{4}$ inch thick.		
WOODEN CORNICES, CUPOLAS, ETC.—79		
Not less than.....	03	
WOODEN AWNINGS—80 On one story buildings.....	10	
81 One story buildings in non-fire department towns.....	10 to .20	
82 On buildings over one story.....	.01	
83 On buildings over one story in non-fire department towns.....	.05 to .10	
LIGHTING—81 Electricity, approved, (if unsafe see No. 154).....	02	
86 Kerosene (no charge if charged for electricity).....	02	
Any other system of lighting must be subject to approval of Local Board of Underwriters and charged for by rule.		
HEATING—87 If by hot air furnace.....	03	
88 Furnace, with metallic cold air box, and all		
HEATING 88—FORWARD (OVER)		

SCHEDULE RATING IN FIRE INSURANCE 263

UNIVERSAL MERCANTILE SCHEDULE—Continued

	No.	Charge
HEATING 88—BROUGHT FORWARD		
vertical hot air pipes through brick walls and one register fastened open, add (instead of No. 87) .....		.02
89 Stoves .....		.02
90 If stove pipes through floors or hollow partitions, protected, each .....		.02
not exceeding a total of .....		.10
For faults of stove pipes Nos. 91, 92, 93, 94 and 95, easily corrected, charge at No. 140.		
96 Natural gas or oil fuel, approved pressure regulating appliances .....		.05
CHIMNEYS—97 Not built from ground, but on brackets, charge for each .....		.05
98 If inadequate for service required, or walls of flues less than 8 inches thick, unless lined with pipe, not less than .....		.05
99 If resting on attic floor beams or roof joists, add .....		.25
(in addition to No. 97)		
100 Poor bricks or mortar (in addition to No. 43) .....		.20
101 Terra-cotta or cement .....		.50
STREET—102 If street on which building fronts is inaccessible, unpaved, etc., not less than (No charge if no fire dept., and no charge for side or rear streets.) .....		.10
103 If less than 60 feet wide, but over 50 ....		.02
104 If under 50 feet, add for each 5 feet less ...		.02
WIRES—105 Overhead to interfere with fire dept. (telegraph, trolley, etc.), not less than ...		.02
TENANTS—106 Each in excess of one, exclusive of office and dwelling tenants .....		.02
106a For each MANUFACTURING TENANT in excess of the highest rated one (which is charged for in No. 128), add 10% of its first column charge in occupancy table		
106b If MANUFACTURING RISK add $\frac{1}{4}$ of .01 for each operative employed in excess of 10 (not exceeding a total of .25 in risks where the first column charge does not exceed .25. In wood working or other hazards where first column charge exceeds .25, double the charge, but total not to exceed 1.00).		
AGE of Building—107 Over 20 years (if in poor repair charge at No. 144) .....		.02

UNIVERSAL MERCANTILE SCHEDULE—Continued

	No.	Charge
FRAME REARS —108 Extensions, etc., not less than.....		.10
If protected with approved metal covering half charge.		
STONE PIERS —109 Stone columns, pillars, or brick piers with bond stones, carrying important weights, charge according to number not less than.....		.05
IRON COLUMNS UNPROTECTED —110 Cast iron .10; steel or wrought.....		.15
STEAM BOILER —111 (other than heating). Charge if in basement .05; above basement, .10; wood shavings for fuel 1.00 additional... If boiler in fire-proof room cut off in approved manner, no charge.		
POWER —112 Charge according to hazard.....		
TOTAL DEFICIENCIES PLUS KEY-RATE		
DEDUCT FOR EXCEPTIONAL CONSTRUCTION.		
	No.	%
117 No cellar or basement, deduct....		10%
118 SMALL RISKS under 1,500 sq. ft. ground floor area and not over 3 stories high.....		10%
119 Tin or sheet-iron between floors..		5%
120 Water-proof paper or cement between floors.....		2%
121 Floors water-proof and also inclined with scuppers to carry off surplus water to sewer.....		5%
121a If floors exceed 3 inches in thickness, deduct 1% for each excess inch (in addition to 119, 120 and 121).....		
122 If grade floor fire-proof.....		10%
123 Each fire-proof floor above grade (not exceeding a total of 40%).....		5%
124 Metallic studs and lathing, throughout.....		10%
125 Metallic lathing on wooden studs..		5%
126 PARAPET WALLS exceeding one foot above roof on all exposed sides, deduct for each foot in excess of one (not exceeding a total of 3%).....		1%
TOTAL.....		%
127 RATE OF BUILDING UNOCCUPIED. Occupied by Nos. (as per table page 143) Add for occupancy (amount in first column of table, page 143.) (Selecting charge for the most hazardous occupancy in the building.)		
128 RESULT—RATE OF BUILDING OCCUPIED....		

UNIVERSAL MERCANTILE SCHEDULE—Continued

	No.	Per Ct.
DEDUCTIONS FOR FIRE APPLIANCES, ETC., ON BUILDINGS.		
155 One hydrant supplied by 8-inch water-main, within 300 feet.....	5%	
156 Two or more hydrants (8-inch) main within 300 feet.....	10%	
157 If said water-pipe be fed at both ends by mains.....	5%; (15% in all)	
(If 6-inch pipe, one-half above deductions No. 155, 156, 157.)		
158 Automatic fire-alarm signal to central station or fire dept.....	5%	
158a Burglar alarm, approved system to central station.....	2%	
158b Special building call direct to fire dept. (one-half allowance if no watchman).....	5%	
159 Chemical engines on wheels, available in case of fire.....	5%	
160 Iron fire-escapes outside of building, with landings at each floor.....	2%	
161 Casks of water or filled pails on each floor (6 filled pails to each 2,500 square feet of floor area), 5%; (if no hydrants within 300 ft., 10%).....		
(One-half number may be filled with sand. One cask may be considered the equivalent of three pails.)		
162 Standpipe, internal with tank supply....	2%	
163 " " without tank supply.	1%	
164 " external with siamese connection for use of fire dept.....	1%	
165 Each side or rear accessible to fire dept. (no deduction for front).....	3%	
166 Fire department house, engine, hose or hook and ladder, within 300 feet, 2%; if next door or on opposite side of street.....	5%	
167 Basement and sub-cellar perforated pipe sprinklers.....	2½%	
168 Automatic sprinklers in basement, (no de- duction if allowance has been made for sprinklers throughout building).....	5%	
169 Occupancy, exclusively dwelling above grade floor, if one family.....	20%	
(If only one floor so occupied, deduct 10%.)		
170 Occupancy, exclusively dwelling if two families.....	15%	

UNIVERSAL MERCANTILE SCHEDULE—Continued

	No.	Per Ct.
171 Occupancy, exclusively dwelling if more than two families.....	10%	
172 Occupancy, if tenement house above grade floor.....	5%	
173 Occupancy, if building occupied throughout exclusively for offices or dwelling and offices.....	25%	
174 Occupancy, if occupied exclusively above grade floor for offices, or offices and dwelling.....	10%	
175 Watchman but no watch clock.....	5%	
176 " with watch clock or electric detector, (one-half deduction for watchman, if automatic alarm No. 158).....	10%	
177 Roof hydrants protected from freezing..	2%	
178 Floor beams and girders self-releasing..	1%	
179 Auxiliary private fire plant, force pump, etc.....	10%	
TOTAL DEDUCTIONS.....		%
EXCEPTIONAL CITY FIRE DEPARTMENT—		
184 Extra steamers, $\frac{1}{2}$ of 1% for each one in excess of five (not exceeding a total of 20%).		
185 Water-towers, if one, 2 $\frac{1}{2}$ %; if two, 5%.		
186 Fire-boat available 5%. 186a Gravity Pressure; for each effective fire stream available at risk, supplied by gravity pressure of not less than 40 lbs. at base of nozzle, by hydrant on 8-inch or larger main, deduct 1% (not exceeding a total of 15%). If 6-inch main one-half deduction.		
These percentages of last net amount, but only one-half the foregoing deductions (except 186) in case supply main from reservoir is not in duplicate, or unless precautions are taken by the city to prevent freezing of hydrants. See note page 47.		
TOTAL.....		%

UNIVERSAL MERCANTILE SCHEDULE—*Continued*

129 RESULT —Net rate of building occupied, unexposed	
130 EXPOSURE —If any, add according to hazard	
130a CONFLAGRATION HAZARD due to congested business district	
131 RESULT —NET RATE OF BUILDING, OCCUPIED AND EXPOSED	
131a AUTOMATIC SPRINKLERS —See rule page 51	
DEDUCT FOR % CO-INSURANCE —See rule page 52..	
On buildings in fire department towns (15% for 80%)....	
On buildings in non-fire department towns (7½% for 80%)	
132 RESULT —NET RATE OF BUILDING OCCUPIED WITH.....	
% CO-INSURANCE	
ADD FOR ADVERSE LEGISLATION , Valued Pol. Laws, Taxation, etc., No. 136, page 42	

ADD FOR FAULTS OF MANAGEMENT, EASILY CORRECTED.

	No.	Charge
140 If stovepipes through floors or partition, not protected, .50; through window, roof or wall, with double metal chimney, .50; not protected, 1.00; entering bottom of flue vertically, 25; entering flue in attic or unused room, etc.	25	
140a Floor beneath stove not protected	05	
141 Bottom of elevator shaft used for closets, etc., or waste	50	
142 Swinging gas brackets or bracket lamps unprotected, for one	05	
each additional one	01	
143 Untidiness, rubbish, ashes, etc., especially in cellar	25	
packing material not in bins	15	
144 Cracked or bulged walls, thin and worn floors, broken plastering, broken windows, etc., ..	10 to 25	
145 Empty boxes, rubbish, etc., in rear yard, alleys, window recesses, under sidewalk gratings, etc.	10	
146 Open lights in show windows or electric bulbs covered with tissue paper or paper shades.	25	
147 Sawdust on floors, sawdust spittoons, etc.	25	
148 Kerosene used to sprinkle floors	25	
149 Ash and waste cans, not metal	10	

UNIVERSAL MERCANTILE SCHEDULE—*Continued*

	No.	Charge
150 Furnace top within 4 inches of wooden beams or ceiling, if brick; or within 12 inches if portable, with metallic shield. ....	.10 to .25	
151 Fire-places, hearths on wooden beams, or floors within 16 inches of fire-place; or wooden fire-boards, or summer pieces, or unprotected wooden mantels, or open stove-pipe holes, .....	.05 to .25	
152 Steam-pipes in contact with wood, not less than. ....	.01	
153 Elevator or other shafts communicating with roof space .....	.25	
154 Electric lighting or other system, with installation not in compliance with underwriters' rules; or arc-lights unprotected by tight globes or metal screens .....	.25	
154a Crowded merchandise without proper aisles, opposite or too near windows, overloading, not less than .....	.25	

FINAL RATE ON BUILDING—(Including Co-ins., charges for faults of management, etc.)

TO OBTAIN RATE ON STOCK.

RATE OF BUILDING OCCUPIED No. 128, above

Deduct a sum equal to one-fourth of the deficiencies of the building

(i. e. one-fourth of excess of item No. 127 over 25 cents) as follows
 —Rate No. 127

cents, minus 25 cents, equals

one-fourth of which

cts. (deducted from 128) leaves

Extend difference into further column.

N. B. This will be the **KEY OR BASIS RATE FOR ALL STOCKS IN THE BUILDING.**

Add amount named in second column of occupancy table for "susceptibility" of the stock to be rated

Add (in other than single occupancy buildings) 5 cts. for each floor on which the stock to be rated is above or below grade

If distributed over two or more floors, add the charges for all and divide by the total number of floors covered to get the average. For example, for third floor 10 cts., fourth 15 cts., and fifth 20 cts., total 45 cts., divided by 3 equals 15 cts. If stock extends only over the three floors—grade, basement and second floor, no charge or deduction. See rule page 58.

UNIVERSAL MERCANTILE SCHEDULE—Continued

GRADE FLOOR STOCKS —If stock exclusively on grade floor in non-fire dept. towns, deduct 10%; in fire dept. towns, deduct 5%; if stock extends only over <i>one</i> additional floor, basement or second, deduct 3%.....	
PUBLIC WAREHOUSES and Storage Stores BONDED , deduct 33 $\frac{1}{3}$ %.....	
PUBLIC WAREHOUSES and Storage Stores FREE , deduct 25%.....	
PRIVATE WAREHOUSES —Original unbroken packages only, 20%. Sales by sample only, 15%. Delivery of broken packages, 10%.....	
123 TOTAL.....	

**DEDUCTIONS FOR FIRE APPLIANCES,
ETC., ON STOCKS.**

	No.	Per Ct
190 If one hydrant, supplied by 8-inch water-main within 300 ft.....		4%
191 Two or more supplied by 8-inch water-main within 300 ft.....		6%
192 Water-pipe fed at both ends by main, additional.....		.4% (10% in all)
(If 6-inch pipe one-half above deductions Nos. 190, 191, 192.)		
193 Automatic fire-alarm to fire dept. or central station.....		5%
193a Burglar alarm, approved system to central station.....		2%
193b Special building call direct to fire department, (one-half allowance if no watchman)....		5%
194 Chemical engines on wheels if one or more		5%
195 Iron fire-escapes outside of building with landing at each floor.....		2%
196 Casks of water or filled pails (at least 6 filled pails to each 2,500 square feet of floor area), 5%; (if no hydrants within 300 ft., 10%).		
197 Standpipe, internal, with tank supply...		2%
198 " external, siamese connection for the use of fire dept.....		1%
199 Each side or rear accessible to fire dept. (no deduction for front).....		3%
200 Fire dept. house, engine, hose or hook and ladder within 300 feet, 2%; if next door or on opposite side of street.....		5%
201 Basement and sub-cellar perforated pipe sprinklers, and stock be on skids.....		2%

UNIVERSAL MERCANTILE SCHEDULE—Continued

	No.	Per Ct.
202 Automatic sprinklers in basement (no deduction if allowance has been made for sprinklers throughout building).....	5%	
203 Occupancy, exclusively dwelling above first floor, if one family.....	20%	
(If only one floor ab occupied, deduct 10%.)		
204 Occupancy, exclusively dwelling if two families.....	15%	
205 Occupancy, exclusively dwelling if more than two families.....	10%	
206 Occupancy, if tenement house above grade floor.....	5%	
207 Occupancy, if building occupied above grade floor entirely for offices.....	5%	
208 Occupancy, if for office and dwelling....	15%	
209 Watchman but no watch-clock.....	5%	
210 " with watch-clock or electric detector (if automatics No. 193, allow only $\frac{1}{2}$ deduction for watchman).....	15%	
211 Roof hydrants protected from freezing..	1%	
212 Fire patrol, supported by city, (if by insurance companies nothing).....	3%	
213 If merchandise covered by tarpaulins each night.....	5%	
214 Merchandise in tin covered cases.....	5%	
215 If merchandise on skids, or platforms...	2%	
217 Auxiliary private fire plant, force pump, etc.....	5%	
TOTAL		%
EXCEPTIONAL CITY FIRE DEPARTMENT—		
219 Extra Steamers, $\frac{1}{2}$ of 1% for each in excess of five (not exceeding 15% in all).		
220 Water-tower, if one, $2\frac{1}{2}\%$; if two, 5%.		
221 Fire-boat, available, 5%. 221a Gravity Pressure; for each effective fire stream available at risk, supplied by a gravity pressure of not less than 40 lbs. at base of nozzle, by hydrant on 8-inch or larger main, deduct $\frac{1}{2}$ of 1% (not exceeding a total of $7\frac{1}{2}\%$). If 6-inch main one-half deduction.		
These percentages of last net amount, but only one-half the foregoing deductions (except No. 221) in case supply main from reservoir is not in duplicate or unless precautions are taken by city to prevent freezing of hydrants. See note page 50.		
TOTAL		%

SCHEDULE RATING IN FIRE INSURANCE 271

UNIVERSAL MERCANTILE SCHEDULE—Continued

124 RESULT —Net rate on stock in unexposed building.....	
N. B. MINIMUM STOCK RATE—The stock rate at this point, No. 134, must exceed that of Building at No. 129 above by an amount equal to 20% of the second column charge in the table for the stock; if it does not, increase it to such figure.	
124a EXPOSURE —If any, add according to hazard.....	
124b CONFLAGRATION HAZARD due to congested district.....	
124c AUTOMATIC SPRINKLERS —See rule page 51.....	
DEDUCT FOR% CO-INSURANCE ($7\frac{1}{2}\%$ for 80%)...	
125 RESULT —NET RATE ON STOCK WITH.....% Co-INSURANCE.....	
ADD FOR ADVERSE LEGISLATION , Taxation, Valued Pol. Laws, 136, page 42.....	
ADD FOR FAULTS OF MANAGEMENT , if any, 140 to 154 above.....	
FINAL RATE ON STOCK —(Including Co.-ins., charges for faults of management, etc.).....	

**SAMPLE PAGE OF OCCUPANCY TABLE USED IN CONNECTION WITH
THE UNIVERSAL MERCANTILE SCHEDULE**

RULE. —From the rate of Building occupied, No. 128, deduct one-fourth of the deficiencies and then add the figure named in the second column of the table for the stock to be rated, proceeding with deductions Nos. 190, 191, etc., as per rating slip.			
NATIONAL BOARD ANALYSIS NO.	CHARGES FOR OCCUPANCY <i>NOTE.</i> —Where stocks are entered in two different places, alphabetically, the reference in each to the other is intended to prevent oversight in case of subsequent revisions of the table, so as to insure that if a rate be changed in one place it shall be in all. For example, Chinese and Japanese goods are entered under both C and J, with a reference in each place to the other. Only one number, however, is assigned to both titles for Fire Cost Analysis.	To the Rate at Nos. 127 & 128 as ascertained by the Schedule	
		Add to No. 127 for Insurance on Building	Add to No. 128 for Insurance on Contents
		Cents	Cents
No. 400	Academies and Private Schools on upper floors of mercantile buildings, in cities		25
401	“ “ Seminaries in cities		25
402	“ “ “ country		25
	Acids (see Warehouse, Nos. 1800, 1825)		
403	“ Manuf’y ¹	125	75
404	Adze Manuf’y (see Hardware Manuf’y)	50	50
405	Agricultural Implements, Stocks of ¹	10	50
406	“ “ Manuf’y ¹ Steam Power	200	50
407	“ “ “ Water Power	150	50
	Add for any exposure ² by Boiler Room Hazard No. 527, Painting, No. 1267, Dry Room, No. 814		
408	Alarms, Fire, Burglar, Annunciators, etc., Manuf’y	40	
409	“ “ Stocks of		75
410	Album Manuf’y	50	100
411	Alcohol and High Wines, in bbls. or casks	25	50
	“ If included in Drug Stock, covered by drug-stock rate		
412	Ale Houses (see Saloons)	5	45
413	Ale, Beer, or Porter, in bottles, cased		50
414	“ “ “ “ “ bbls. or casks		40
415	b Almshouses, brick (see also Poor Houses)	100	25
415f	“ “ frame	100	25
417	Aluminum Manuf’y	75	50
	Ammunition, fixed, Manuf’y (see Cart. Manuf’y, No. 646)		
418	Anchors, Anvils		10

SAMPLE OF BASIS TABLES USED UNDER THE ANALYTIC SCHEDULE

60

Protection

Height	Class 1	Class 2	Class 3	Class 4	Class 4½	Class 5	Class 6
1 story.....	\$0.33	\$0.37	\$0.42	\$0.47	\$0.52	\$0.57	\$0.60
2 stories.....	.34	.39	.44	.49	.54	.59	.63
3 stories.....	.36	.40	.46	.52	.57	.62	.66
4 stories.....	.38	.43	.49	.55	.61	.66	.70
5 stories.....	.41	.47	.53				
6 stories.....	.46						
Increase for each additional story.....	.07	.07	.07	.07	.07	.07	.07
Decrease if no basement	.02	.02	.02	.02	.03	.03	.03

80

Protection

Height	Class 1	Class 2	Class 3	Class 4	Class 4½	Class 5	Class 6
1 story.....	\$0.43	\$0.49	\$0.55	\$0.63	\$0.69	\$0.75	\$0.80
2 stories.....	.46	.52	.58	.66	.73	.79	.84
3 stories.....	.48	.54	.61	.69	.76	.83	.88
4 stories.....	.51	.57	.65	.73	.81	.88	.94
5 stories.....	.55	.62	.71				
6 stories.....	.61						
Increase for each additional story.....	.10	.10	.10	.10	.10	.10	.10
Decrease if no basement	.02	.03	.03	.03	.04	.04	.04

100

Protection

Height	Class 1	Class 2	Class 3	Class 4	Class 4½	Class 5	Class 6
1 story.....	\$0.54	\$0.61	\$0.69	\$0.78	\$0.86	\$0.94	\$1.00
2 stories.....	.57	.64	.73	.82	.91	.99	1.05
3 stories.....	.60	.67	.76	.86	.95	1.04	1.10
4 stories.....	.63	.72	.81	.92	1.01	1.10	1.17
5 stories.....	.69	.78	.88				
6 stories.....	.76						
Increase for each additional story.....	.12	.12	.12	.12	.12	.12	.12
Decrease if no basement	.03	.03	.04	.04	.04	.05	.05

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**EXAMPLE OF THE CALCULATION OF A BRICK BUILDING RATE UNDER
THE ANALYTIC SCHEDULE**

(Illustration selected from J. S. Glidden's "Analytic System for the Measurement of Relative Fire Hazard: An Explanation," 1916, p. 50.)

60 Table—Third Class Protection

Basis—four stories, no basement (\$0.49-.02)		\$0.47
Area—4,000 square feet, four floors 14% less one-tenth or 1% for interior wall	13%	
Walls—sides are 16-12-12-12 average 13 in., should be 20-16-16-12, average 16 in. deficient each 3 in., at 3%	6%	
One wall party, add	4%	
Parapets—one deficient in height	4%	
Iron and Glass store front first story, over 25 feet ..	6%	
Ceilings and Walls wood sheathed—2 floors	6%	
Skylight—one 70 square feet, not standard	4%	
Floorways grade "B" with two "below a" openings each floor (6% × 3)	18%	
Partitions—one wooden lath and plaster, basement and first floors, between tenants	6%	
Exterior Attachments—one metal-clad frame roof house over elevator	5%	
Occupancy (assumed)	48%	
Total charges added and extended	120%	<u>.56</u>
Occupied building rate		<u>\$1.03</u>

**SAMPLE SECTION OF THE ALPHABETICAL OCCUPANCY TABLE USED
UNDER THE ANALYTIC SYSTEM**

(The following is reproduced from J. S. Glidden's "Analytic System for the Measurement of Relative Fire Hazard: An Explanation," 1916, p. 65.)

The factors of hazard found in occupancies are divisible into

1st: CAUSES, i.e., the things which originate combustion.

2d: MEDIA, i.e., the substances on which the causes act with reference to their latent energy or combustibility.

3d: EFFECTS, i.e., the relative susceptibility of media to damage as the direct or indirect results of fire—commonly known as damageability.

NOTE: The Alphabetical Occupancy List contains three columns which may be respectively designated as the columns of Cause, Combustibility and Damageability.

The following excerpt from the Alphabetical Occupancy List will serve to illustrate the classification:

	1	2	3
195 Bolt, Nut and Screw Stocks.....	5%	10%	D2
196 Bonnet and Hat Frame Factories.....	15%	20%	D3
1. Additional labor, power, heat, etc. (C. 3)			
197 Book Bindery, (no printing).....	25%	40%	D3
1. Additional labor, power, heat, etc. (C. 3½)			
2. Book Bindery with Printing. See Printing			
198 Book Binders' Supplies.....	5%	10%	D2
199 Book and Stationery Stocks.....	5%	10	%D3
200 Bootblacking Parlors.....	3%	....	D2
201 Boot and Shoe Stocks (retail).....	5%	10%	D2
202 Boots and Shoes (wholesale), including Rubber Goods.....	3%	5%	D1½
203 Boots and Shoes (wholesale), Rubber goods only	3%	5%	D1

Note the three columns marked 1, 2 and 3. Column 1 is the column of causes. Column 2 is the column of combustibility which is referred to in some localities as ignitibility. Column 3 is the column of damageability sometimes called susceptibility or classification. The charges given in columns 1 and 2 are percentages of the basis rate. The letter D in the third column means damageability and the numbers after the letters are merely symbols representing the proper charges to be taken from contents tables printed in the schedule.

**SAMPLE ILLUSTRATION OF A "CONTENTS TABLE" AS USED IN
CONNECTION WITH THE ANALYTIC SYSTEM**

(NOTES: "The following tables show amount to be added to occupied building estimate to obtain estimate on contents, according to damageability and location in building under each grade of protection.")

"In Alphabetical Occupancy List, certain occupancies are designated by a star. The differential between these occupancies and their containing building should be less than with ordinary occupancies. This difference is a fixed sum for each grade of protection and is named at the head of each of the following tables. The amount named should be deducted from the differential stated in the table below, whether the contents be contained on one or more floors.")

CONTENTS TABLE

No. 75

SIXTH CLASS PROTECTION

<i>Location of Contents</i>	<i>D1</i>	<i>D1½</i>	<i>D2</i>	<i>D2½</i>	<i>D3</i>	<i>D3½</i>	<i>D4</i>
Basement.....	\$0.16	\$0.21	\$0.25	\$0.33	\$0.41	\$0.49	\$0.57
Ground floor.....	.08	.12	.15	.23	.30	.38	.45
Second floor.....	.16	.21	.25	.33	.41	.49	.57
Third floor and over.....	.21	.26	.31	.40	.48	.57	.66

FIFTH CLASS PROTECTION

(Deduct .04c for *)

Basement.....	\$0.18	\$0.23	\$0.28	\$0.37	\$0.45	\$0.54	\$0.62
Ground floor.....	.10	.14	.18	.26	.34	.42	.49
Second floor.....	.18	.23	.28	.37	.45	.54	.62
Third floor and over.....	.24	.29	.34	.43	.52	.61	.70

FOUR AND A HALF CLASS PROTECTION

(Deduct .07c for *)

Basement.....	\$0.21	\$0.27	\$0.33	\$0.42	\$0.50	\$0.59	\$0.68
Ground floor.....	.13	.18	.23	.31	.39	.47	.55
Second floor.....	.21	.27	.33	.42	.50	.59	.68
Third floor.....	.27	.33	.39	.48	.57	.67	.76
Fourth floor and over.....	.32	.39	.45	.55	.64	.74	.84

FOURTH CLASS PROTECTION

(Deduct .09c for *)

Basement.....	\$0.24	\$0.31	\$0.37	\$0.46	\$0.55	\$0.65	\$0.74
Ground floor.....	.16	.22	.28	.36	.44	.53	.61
Second floor.....	.24	.31	.37	.46	.55	.65	.74
Third floor.....	.30	.37	.44	.53	.62	.72	.82
Fourth floor and over.....	.35	.43	.50	.60	.70	.80	.90

THIRD CLASS PROTECTION

(Deduct .11c for *)

Basement.....	\$0.28	\$0.25	\$0.42	\$0.52	\$0.61	\$0.71	\$0.80
Ground floor.....	.19	.26	.33	.42	.50	.59	.68
Second floor.....	.28	.35	.42	.52	.61	.71	.80
Third floor.....	.33	.41	.49	.59	.68	.79	.89
Fourth floor.....	.38	.47	.55	.65	.75	.86	.97
Fifth floor and over.....	.44	.53	.62	.73	.83	.94	1.06

SCHEDULE RATING IN FIRE INSURANCE 277

SECOND CLASS PROTECTION

(Deduct .11c for *)

Basement.....	\$0.30	\$0.39	\$0.47	\$0.57	\$0.66	\$0.76	\$0.86
Ground floor.....	.22	.30	.37	.46	.55	.65	.74
Second floor.....	.30	.39	.47	.57	.66	.76	.86
Third floor.....	.36	.45	.53	.63	.73	.84	.95
Fourth floor.....	.41	.51	.60	.70	.80	.92	1.03
Fifth floor.....	.47	.57	.66	.77	.88	1.00	1.11
Sixth floor.....	.52	.62	.72	.84	.95	1.07	1.19
Seventh floor and over.....	.58	.69	.79	.91	1.02	1.15	1.27

FIRST CLASS PROTECTION

(Deduct .12c for *)

Basement.....	\$0.32	\$0.41	\$0.50	\$0.60	\$0.70	\$0.81	\$0.92
Ground floor.....	.24	.33	.41	.50	.59	.69	.79
Second floor.....	.32	.41	.50	.60	.70	.81	.92
Third floor.....	.38	.48	.57	.68	.78	.89	1.00
Fourth floor.....	.43	.53	.63	.74	.85	.97	1.08
Fifth floor.....	.49	.60	.70	.81	.92	1.04	1.16
Sixth floor.....	.54	.65	.76	.88	.99	1.12	1.24
Seventh floor.....	.60	.71	.82	.95	1.07	1.20	1.33
Eighth floor and over.....	.65	.77	.89	1.02	1.14	1.28	1.41

CHAPTER XIX ✓

UNDERWRITERS' ASSOCIATIONS

Insurance Inherently a Coöperative Enterprise.—In probably no other form of business activity is there so much need for concerted action as in insurance.¹ Fire and marine insurance, particularly, require the intimate coöperation of the companies along many important lines if the public is to be served properly. The business is highly technical, and it is, therefore, essential that it be not only based on the combined experience of all participating companies, but that numerous technical investigations be undertaken. Work of that type, it is clear, can be performed most advantageously if the companies unite for the purpose. The public, on the other hand, is interested in uniform and fair practices, in the economical conduct of the business, in premium rates which properly measure the hazard and which are adequate and fair and not discriminatory as between different policyholders, in the prompt and fair adjustment of losses, and in the application of devices and measures which have for their purpose the prevention of loss.

All of these, as well as other important factors, can best be realized if the companies will take concerted

¹For a detailed discussion of fire underwriters' associations see Robert Riegel's thesis on "Fire Underwriters' Associations in the United States," 1916; also his article on "Rate-making Organizations in Fire Insurance," *Annals of the American Academy of Political and Social Science*, Volume 70, pp. 172-198. For a detailed discussion of underwriters' associations in marine insurance, see S. S. Huebner: "Marine Insurance," Chapter XV on "Marine Underwriters' Associations," pp. 169-179.

action with respect thereto. Open competition instead of being the "life of business," as was once so generally believed, has proved to be the source of numerous discriminatory practices and the financial instability of the companies. Coöperation through underwriters' associations, if properly conducted, leads to stability of rates, strengthens the companies financially by avoiding cut-throat competition, results in the adoption of higher standards of business conduct and a better supervision of the business, and tends to eliminate unfair discrimination.

Fire Underwriters' Associations Classified.²—Such associations are numerous, and from the standpoint of

² Dr. Robert Riegel, in his thesis on Fire Underwriters' Associations in the United States, classifies such Associations from a three-fold standpoint, namely (1) on the basis of the extent of territory in which they operate; (2) according to their functions or objects; (3) with reference to the character of membership. His classification is as follows:

CLASSIFICATION OF ASSOCIATIONS

According to

1. Jurisdiction.....	<div> <div>National</div> <div>Sectional</div> <div>Local.....</div> </div> <div> <div>Urban</div> <div>Suburban</div> </div>
2. Functions.....	<div> <div>Technical and educational</div> <div>Regulation of brokers and agents and rate-making</div> </div>
3. Membership	<div> <div>Occupation of members</div> <div>Classification of members</div> <div>Requirements</div> </div> <div> <div> <div>Company representatives</div> <div>Special agents</div> <div>Agents and brokers</div> <div>No distinction between members</div> </div> <div> <div>Classified membership</div> <div> <div>1. Without qualification of voting power</div> <div>2. With qualification of voting power</div> </div> </div> <div> <div>Adherence to agreed commissions to agents</div> <div>Adherence to stated scale of brokers' compensation</div> </div> </div>

territorial jurisdiction may be classified into (1) local associations, (2) sectional associations, and (3) national associations. Local associations, which are either "urban" or "suburban," usually have jurisdiction over the larger cities or the suburban territory immediately connected therewith. Thus, with respect to New York and Philadelphia, the New York Fire Insurance Exchange and the Philadelphia Underwriters' Association have jurisdiction over the two cities proper, whereas in each case there is also a suburban association. In some instances, control by local associations extends to several counties. Despite their limited territorial jurisdiction, their importance is extremely great, because they usually have charge of the supervision of brokers, agents, commissions and rates.

Sectional associations differ from the local ones mainly in the fact that their jurisdiction extends to a much larger territory, varying from one or a few to nearly half of the United States. In this group there should be mentioned the Eastern Union (covering the country East of the Mississippi), the Western Union (covering the Middle West), the New England Insurance Exchange, the Underwriters' Association of New York State, the Underwriters' Association of the Middle Department (operating in Pennsylvania, Delaware, Maryland, and West Virginia), the Southeastern Tariff Association (covering the Southern states), the Rocky Mountain Fire Underwriters' Association, and the Underwriters' Association of the Pacific. The work of these Associations is in large measure the same as that performed by the local organizations. Although their jurisdiction does not extend to the territory of the local organizations, they nevertheless exercise considerable indirect influence over the activities of the local boards.

National associations direct their efforts along educa-

tional and fire prevention lines, whereas the local organizations, on the contrary, devote themselves primarily to the practical phases of the business, such as rates, commissions and the supervision of agents and brokers, although they also manifest much interest in educational and conservation work. The National Board of Fire Underwriters and the National Fire Protection Association are the outstanding national organizations in the field of fire insurance.

Membership and Government.—The national and certain of the sectional associations are purely company organizations and comprise within their membership nearly all of the nation's large stock companies. With respect to many of the organizations the company membership is largely the same, with the result that a more or less harmonious relationship exists between the associations involved. Some of the sectional associations confine membership to special agents, while in the local organizations membership consists of officers of local companies, managers, agents and brokers.

Aside from the usual officers, the government is principally by committees, such as the Executive Committee, Committee on Brokerage, Committee on Arbitration, Committee on Losses and Adjustment, Committee on Grievances, etc. Funds to defray expenses of maintenance are usually assessed upon the membership, and in case of company members, on the basis of premium income.

Services Rendered.—While underwriters' associations were formed for mutual counsel among, and protection of the members, their work has become increasingly charged with public service. Most of the benefits resulting are of mutual interest to both underwriters and property owners. Briefly stated, the most important functions of such associations are:

Fixing and standardization of rates.—Not only have

permanent means been established for the elaborate collection of experience for the purpose of arriving at just rates, but underwriters' associations have also been instrumental in the creation and enforcement of rating schedules. The numerous advantages resulting to the public from schedule rating have already been discussed and need not be repeated. As pointed out by Dr. Riegel: "One of their greatest services has been the creation of uniformity in charges and the prevention of discrimination between localities, classes of risks, kinds of policies and persons. They have eliminated the rate-wars previously referred to, with their demoralization of business and deterioration of the value of the insured's policy. They have attempted the classification of loss statistics. . . . Through the medium of certain associations standard tables have also been adopted for quoting rates on insurance for a term of less than one year, known as short-rate tables." The Actuarial Bureau of the National Board of Fire Underwriters has become one of the largest permanent statistical services in the world. It serves, as stated recently, "as an economic clearing house for the collection and dissemination of valuable data, and brings about a considerable saving to each company."³ The main purpose of its work, as pointed out by Dr. Riegel, "is the compilation of statistics to the end that a complete and carefully compiled record of all fire losses upon insured property in the United States may be obtained, with full information regarding occupancy, location and character of property, values, insurance, origin of fire, etc., and for the investigation of the fire dangers to which each class of property is subject, and the development of thorough and scientific information concerning the causes of fire and their prevention."

³ John B. Morton: "The Service of the National Board of Fire Underwriters." *The Economic World*, 1922, p. 778.

Supervision of brokers and agents.—Adherence to a uniform scale of commissions is one of the fundamental purposes of local and certain of the sectional associations. Certification of brokers is also resorted to with a view to excluding the unfit and to limiting the vocation to those who devote their full time to the business or its closely allied occupations. Adherence to rates is also insisted upon, and rebating of commissions is prohibited under heavy penalty. Policies and all endorsements thereon, immediately upon being written by agents or brokers, must also be submitted to the association for approval by the stamping department or some other department, and the company is required to cancel the same if disapproved. In this way, much non-concurrent insurance that would otherwise arise, is eliminated.

Economy in the conduct of business.—With so many companies in operation, the fire insurance business easily lends itself to the unnecessary duplication of work. This is true in the field of rating, inspections of property, adjustment of losses, and many other phases of the business. Wherever possible such unnecessary duplication is eliminated, sometimes by agreement, and at other times by establishing a common central service. Particularly in the matter of brokers' and agents' commissions have the associations been energetic in standardizing the same and keeping them within reasonable bounds.

Uniform practices and forms.—The benefits of a standard policy have already been outlined, and underwriters' associations, it should be stated, have been instrumental in securing its adoption by law, or in the absence of such legislation, in having it used by all the member companies. Similarly, the various associations have rendered great service in formulating, standardizing and enforcing the numerous endorsements and clauses necessary in the business.

Prompt and equitable adjustment of losses.—The National Board of Fire Underwriters has a Committee on Adjustments, which has done much to overcome the evils connected with loose adjustments. Particularly valuable has been the work of the committee in preparing an emergency equipment for the adjustment of losses arising out of large conflagrations, and which is based upon the experience obtained in the conflagrations of the past.

Elimination of objectionable practices.—Through mutual acquaintance, as well as the expulsion of undesirable members, much is accomplished towards the stamping out of rebating and fraud. Likewise, practices inherently essential to a just conduct of the business, such as coinsurance, for example, are enforced as regards all the member companies. Most of the local and sectional associations have a so-called Grievance Committee, where fellow-members, and through them the public, are enabled to file complaints and thus obtain redress against the fraudulent or sharp practices of other members.

Improvement in legislation.—Probably no business has been the subject of so much ill-advised legislation as insurance. It is essential that there should be concerted action in blocking unjust legislation, such as anti-compact, valued policy, anti-coinsurance, and retaliatory laws. Likewise, concerted effort is necessary to secure the adoption of beneficial legislation. The National Board of Fire Underwriters at present has a Committee on Laws, that carefully examines all legislation affecting the business and that keeps all the members constantly advised.

Standardization and improvement of building laws.—Through its Committee on Construction of Buildings, the National Board of Fire Underwriters has prepared a national building code, which is generally recognized as a standard for safe construction. Expert service and

advice is also given to municipal and state authorities in relation to legislation dealing with the subject. Recently the Association has been working with the United States Bureau of Education, the Department of Agriculture, and the Department of Commerce in the standardization of building laws.

Reduction in the fire waste.—The enormous annual fire waste in the United States is one of the regrettable phases of our economic life. The National Board of Fire Underwriters is pursuing various plans for bringing about an improvement. The most important of these are:

(1) The preparation of a fire prevention manual for use in the schools, as well as the publication (by the National Fire Protection Association) of scores of handbooks, prepared by leading experts, dealing with fire preventive appliances and fire retarding materials and types of construction. Special attention is also given to the printing and distribution of standard specifications for the proper installation of lighting, heating and ventilating systems. The circulation of many of these handbooks has been immense, whereas of the fire prevention manual referred to some 750,000 copies have been distributed as a textbook on the subject.

(2) The preparation of municipal surveys with a view to ascertaining the facilities of the cities involved for protection against fire. Elaborate reports are issued dealing with fire department organization and equipment, water-works system, fire alarm system, etc. Several hundred cities have been inspected, and city officials and fire departments everywhere regard these surveys as the authorized basis for planning improvements.

(3) Inspections for the purpose of supervising the installation and maintenance of electrical, sprinkler, and similar types of equipment. Thus it is customary for electric companies to refuse current to consumers until

the wiring has been approved by the local underwriters' association.

(4) Testing and labeling of appliances relating to the fire hazard by the Underwriters' Laboratories, a corporation owned entirely by the National Board of Fire Underwriters. Quoting its own language, "the object of Underwriters' Laboratories is to bring to the user the best obtainable opinion on the merits or demerits of appliances in respect to the fire hazards. Such appliances include those designed to aid in extinguishing fire, such as automatic sprinklers, pumps, hand fire appliances, hose, hydrants, nozzles, valves, etc.; materials and devices designed to retard the spread of fire, such as structural methods and materials, fire-doors and shutters, fire-windows, etc.; and machines and fittings which may be instrumental in causing a fire, such as gas and oil appliances, electrical fittings, chemicals and the various machines and appurtenances used in lighting and heating." Having tested and approved an appliance, it is listed and labeled as satisfactory. The record and impartiality of the organization is such that during 1921 American manufacturers used nearly a half billion of its labels.

(5) Prevention of and punishment for incendiarism and arson. A special Committee on Incendiarism and Arson of the National Board of Fire Underwriters co-operates with the various committees of the local associations. The companies contribute to a common fund and rewards are offered for convictions. Special arson investigators are employed, and their assistance is constantly requested by sheriffs, district attorneys and other municipal and state officials.

Education of the public.—Most of the previous discussion clearly shows the concerted action of the companies in educating the public along all important lines affecting the business. In this work of education the National

Fire Protection Association and the National Board of Fire Underwriters reach practically the entire population of the country. The former includes among its membership national institutions and societies, state associations and insurance boards interested in the protection of life and property against fire; national, state and municipal departments, chambers of commerce, and individuals engaged in the fire insurance business; and architects, engineers, electricians, building contractors, and others who subscribe for its publications. The latter, as its president recently stated, is "a channel through which amiable relations have been established with the National Association of Insurance Agents, the National Convention of Insurance Commissioners, the State Fire Marshals' Association, the International Association of Fire Chiefs, the National Fire Protection Association, and various sectional organizations, and, what is quite as important, with the public."⁴

Anti-compact Legislation.—Most of the opposition to underwriters' associations has been directed against their rate fixing functions. Under the common law rate fixing associations were, with comparatively few exceptions, regarded as legal by the courts. This was due chiefly to the difficulty of proving that such organizations were operating in unreasonable restraint of trade in a business vitally essential to the public welfare. With the formation of "trusts" in many lines of business, however, there soon developed a strong public opposition to combinations in general. This took concrete form in numerous so-called anti-trust statutes, which, according to their wording, were made applicable to "trade," "commerce," "business" or "dealings in commodities."

⁴John B. Morton: "The Economic World," 1922, p. 778.

Since public opposition also extended to underwriters' associations, the question soon arose as to whether the anti-trust statutes applied to insurance, i.e., whether insurance could be construed as being embraced within such terms as "business," "trade," etc. Certain courts decided that such a construction was inadmissible, and in other instances the matter was left in doubt. Accordingly laws were passed which specifically mentioned insurance and which prohibited any agreement or combination for the regulation or fixing of premiums. Such laws, commonly called anti-compact laws, have been upheld as not being in violation of state or Federal constitutional provisions relating to the "right of contract," "equal protection under the laws" and "due process of law." It may be stated that in 1920, twenty-four states still had anti-compact laws applicable to fire and marine insurance.

State Regulation of Underwriters' Associations.—Anti-compact legislation, however, is on the decline. The numerous advantages resulting from concerted action among companies are becoming too apparent to justify any longer a policy of breaking up of all coöperative effort. The tendency is distinctly towards legislation permitting coöperative rating under the supervision of the state, as in New York, Pennsylvania and various other leading states.

The purpose of such legislation is to retain the good features of underwriters' associations and at the same time protect the public against possible abuses. The New York law⁵ will serve to make this clear. It provides that every "corporation, association, bureau or board," which exists for the "formulation, fixing, promulgation,

⁵ A. J. Parker, Jr.; "Insurance Law of New York," 1919, pp. 297-301.

applying or maintaining" of rates in fire insurance, shall (1) file its articles of agreement, by-laws and all other information concerning its organization; (2) be subject to the supervision and examination of the Superintendent of Insurance, who may make an examination as often as he deems expedient; (3) file with the Superintendent of Insurance any and every schedule of rates; (4) keep careful records of its proceedings, and give full information as to the rate and the schedule used for rating purposes to any persons upon whose property or risk a rate was made; and (5) give any person affected by its rates an opportunity to be heard "before the Governing or Rating Committee or other proper executive of such rating organization on an application for a change in such rates." But while thus permitting regulated co-operation, the statute explicitly prohibits associations or bureaus from doing certain things. Thus discrimination in rates is forbidden, and the Superintendent of Insurance may order the same removed after investigating the case. Nor may the associations require (1) that all insurance must be purchased from its members, or (2) that the rates quoted shall not be made to apply "on the condition that the whole amount of insurance on such risk or any specified part thereof shall be placed at such rates."

Marine Underwriters' Associations.⁶—In marine insurance, as contrasted with fire insurance, rates are anything but fixed, and brokers have for years acted as free-lances in the business. Competitive conditions, largely of an international character, prevail to such an extent that all past efforts of underwriters to effect co-

⁶For a detailed statement of the character and functions of the various associations, see S. S. Huebner: "Marine Insurance," Chapter XV on "Marine Underwriters Associations," pp. 169-179.

operative arrangements for the purpose of stabilizing rates either have failed or been confined to the mere recommendation of rates.

But while marine insurance interests have thus far failed to coöperate effectively in the actual making and enforcement of rates, there are nevertheless many matters of such a nature as to make coöperation between companies highly desirable with a view to applying correct principles and to developing and enforcing uniform, efficient, and economical practices. Such coöperation between underwriters has been effected through the creation of numerous so-called marine underwriters' associations. Their functions are limited to the supervision and improvement of various matters relating to the conduct of business, such as the establishment of just principles, the adjustment of losses, the conduct of salvaging operations, the inspection of the loading of vessels, the adoption of policy forms and conditions, the recommendation of rates for certain classes of risks where that is possible, the legitimate advancement or defeat of vital legislation, the extension of American insurance interests in foreign countries, and the safeguarding and development of the business in the interest of the members. At least 14 such associations play a prominent part in American marine insurance. They may be grouped into two classes, viz., "non-rate-recommending" and "rate-recommending" associations. Six of these associations belong to the first-class, viz., the Board of Underwriters of New York, the American Institute of Marine Underwriters,⁷ the Association of Marine Underwriters of the United States,⁸

⁷ Membership extends to all marine insurance corporations organized under the laws of any state of the United States, or if organized in a foreign country, duly admitted to transact business in this country.

⁸ Membership extends to all American companies.

the National Board of Marine Underwriters,⁹ the Board of Marine Underwriters of San Francisco, and the American Foreign Insurance Association.

The last-named organization—the American Foreign Insurance Association—deserves special mention because of the importance of establishing American branch offices in the interest of American commerce. This association, consisting of 20 leading American fire and marine insurance companies was organized, as stated in its constitution, to “perfect, maintain and operate an organization for the development, extension, and proper conduct of fire and marine insurance and the allied branches of fire and marine insurance in territory other than the North American Continent, Cuba, Porto Rico, West Indies, Newfoundland, and Hawaii.” Each member is under obligation to use all honorable means to advance the interests of the association in its expressed purposes, and no member is allowed directly or indirectly to write or assume any business of the classes in which it participates in the territory operated by the association, except by way of participation through the association. Should any reinsurance treaties conflict with this, the same must be terminated not later than January 1, 1922. A retiring member must also give an undertaking to the effect that in any territory in which the association operates it will not, during a period of two years after

⁹ Membership consists of three classes, viz., resident members comprising officers, managers, agents or representatives authorized to write for any American and foreign marine underwriting company, authorized to transact business in New York City; associate membership consisting of officers, managers, agents or representatives of any American or foreign marine insurance companies authorized to do business in the United States but not maintaining an office in New York City; honorary membership consisting of officers, managers, agents or representatives of marine insurance companies or of kindred associations or corporations as may be elected from time to time.

its resignation is effective, accept through any office, agent, or other representative of the association any direct business for its own account in the class or department in which it participated as a member of the association.

The rate-recommending associations comprise the American Hull Underwriters' Association (relating to ocean-going hulls), the Atlantic Inland Association (relating to inland vessels and coastwise tugs and barges), the American Schooner Association, the Provincial Underwriters' Association (relating to hulls and certain types of cargo in the particular traffic referred to), the Yacht Association (relating to yachts and motor boats used exclusively for pleasure purposes), the Steam Schooner Agreement (the Pacific Coast), and the "Postal Insurance" and "Tourist Insurance" Underwriters' Conferences. These associations or conferences differ from those mentioned in Chapter XIII in that they do not exist for the purpose of effecting reinsurance or otherwise distributing risks. While participating in some of the functions performed by the other group, especially the adoption of uniform policies and forms, their distinguishing feature is the recommendation of rates to their members. In nearly all cases, however, strong emphasis is placed upon the "mere recommendation" of rates, thus affording a strong contrast to the general practice prevailing in the fire insurance business. In many instances, however, particularly with reference to certain trades or types of risk, it is clear that the practice of "recommending rates" through marine underwriters' associations is equivalent for all practical purposes to their general adoption by all members. There is, however, no definite obligation which binds the members to observe the rates as recommend. Instead, officials of the several associations have emphasized the point that, while

the conferences recommend rates for the guidance and mutual benefit of the members, they are not bound to accept these recommendations and are at liberty to withdraw from the association at any time. It should also be observed that in nearly all instances these rate recommending associations are very informal in character and do not operate under a constitution and by-laws.

CHAPTER XX

FIRE PREVENTION

American Fire Waste Compared with that of Europe.

—Fire prevention in the United States presents problems of a totally different character from those met with in other leading countries. In Europe buildings are comparatively low, of limited area and frequently with wide spaces between them. They are, as a rule, of solid masonry construction and provided with comparatively small window openings. In the United States, on the contrary, business exigencies have not been conducive to the adoption of such precautionary measures. American cities have been built rapidly and, until recent years, as cheaply as possible. Wood, because of its cheapness and abundance, has been used extensively in the construction of floors, roofs and walls. The congestion of business sections in our large cities has also become alarming and has often not been marked by a corresponding effort to prevent conflagration. Moreover, as contrasted with the United States, good building regulations have long been used by European countries and are strictly enforced. Usually also, all fires are thoroughly investigated by the police authorities with a view to imposing full responsibility upon those whose negligence may have caused the loss. In fact, many European cities follow the plan of having the police assume immediate possession of the premises in the event of fire and of deferring the collection of insurance money until assent has been obtained from the proper city authorities.

In view of the conditions just outlined it is only natural that there should result an enormous fire waste in the

United States, aggregating annually about \$300,000,000, despite the most efficient fire department protection in the world. In our largest cities property owners are complaining loudly of the heavy insurance tax and insurance companies are confronted with much opposition from policyholders and legislators. The total tax is unquestionably excessive, but any effort to make the same smaller must be directed to the reduction of excessive fire waste itself. Too much emphasis has been placed by property owners on insurance rates and too little on ways and means of reducing the fire loss, despite the fact that rates bear a direct relation to the size of such loss. As previously noted, our factory mutuals emphasize fire prevention above everything else, and the remarkably low insurance cost of these companies (representing less than one-tenth of the cost prevailing before such fire prevention efforts were undertaken) is the result of the rigid enforcement of stringent rules relating to fire prevention.

In European countries, like England and France, the per capita fire loss is only between one-third and one-fourth of that prevailing in the United States. As reported by the Special Committee on Fire Waste and Insurance of the United States Chamber of Commerce, the average annual per capita losses for leading European countries for the years 1912-15 were as follows: France 74 cents, England 64 cents, Norway 55 cents, Italy 53 cents, Sweden 42 cents, Germany 28 cents, Switzerland 13 cents and the Netherlands 11 cents. These figures compare with an annual average per capita loss in the United States, during the same years, of \$2.26. Canada alone among other leading countries showed a larger per capita loss, viz., \$2.96. Mr. F. H. Wentworth, of the National Fire Protection Association, reports that the fire waste of the United States and Canada is roughly ten times as much per person as in Europe. Our annual loss means a direct

annual fire tax of between \$11 and \$12 for every family of five in the country. But if to the actual loss there is added the cost of maintaining fire departments and other equipment, this tax per family easily reaches twice that figure.

Fire underwriters are agreed that it is in the field of fire prevention that the main solution of present difficulties must be found, and for years the experts of insurance companies have studied American conditions in detail and have devised methods of construction and facilities for prevention, which, if generally adopted, would bring about a decided improvement. In fact, fire prevention has assumed such importance that there has developed a special science, called "fire insurance engineering," that concerns itself with the construction of buildings from a fire prevention standpoint, the hazard connected with the occupancy, the exposure from surrounding risks, and the installation of fire protection facilities.

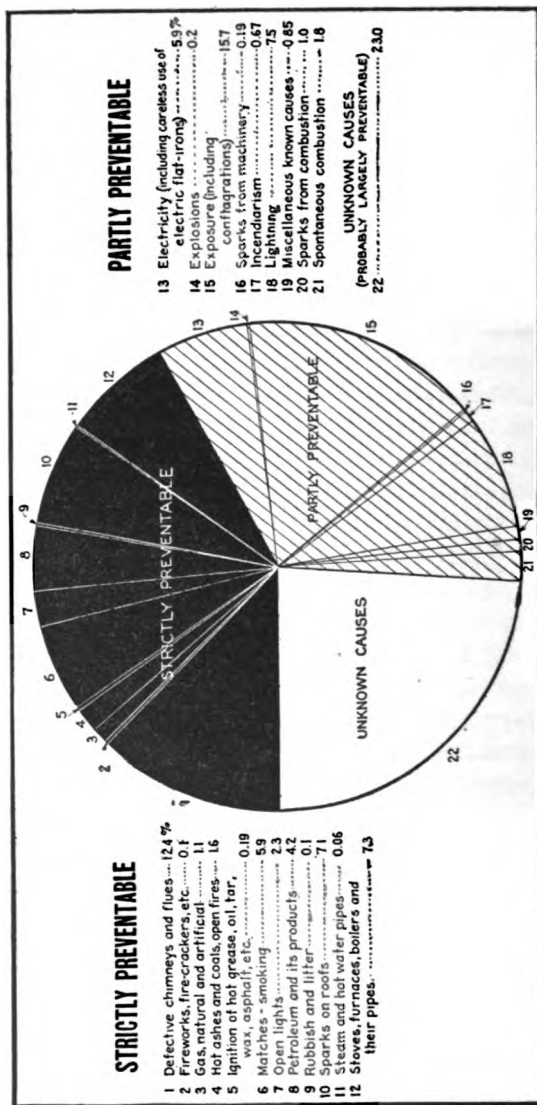
Expenditures for Fire Prevention a Good Investment.—Granting the truth of the foregoing, the question will naturally be asked: How may property owners, who are always viewing their affairs from the standpoint of profit, be induced to adopt improved methods of construction and fire prevention facilities? The answer is that the surest way to bring about reform in these particulars is to appeal to the selfish interests of property owners. If the owner of a business establishment can be shown that the installation of an automatic sprinkler service, for example, will mean a large reduction in his fire rate, and that the saving in his fire insurance bill will amount to considerably more than a good investment return on the capital expended for such a service, it is only reasonable to expect that the improvement will be made. That there is a decided saving along many lines can easily be demonstrated by consulting any rating schedule in common use.

But to regard the value of proper construction and fire preventive appliances in this light only is a short-sighted policy. Although not netting a full interest return on the capital invested, most owners should nevertheless be willing to introduce improved methods. They should aim to avoid that great loss, so frequently overlooked, which consists of the inconvenience, the loss of time, and the loss of business to competitors so inseparably connected with every large fire. To many owners the avoidance of such losses often represents a cash value of far greater importance than a mere good investment return on the money expended. Too often business men hold to the fallacy that full insurance against the loss of the property, as well as its use and occupancy, means that they do not stand to lose much. Yet even use and occupancy insurance cannot indemnify the insured fully against all loss connected with a period of business interruption. There is still, in the overwhelming number of cases, the danger of the permanent loss of customers, who, during the period of business interruption, are served by competitors. The best and only type of insurance against this kind of loss is fire prevention.

Carelessness and Thoughtless Indifference as a Factor in Increasing Fire Loss.—The greatest cause of fire is gross carelessness and thoughtless failure to observe ordinary precautions in the avoidance of fires easily preventable. Certain conditions, especially inferior construction, take many years to correct. But the serious causes of fire, occasioning probably 75 per cent of all fires reported, can be removed at once if owners and tenants will only coöperate in the effort, and at extremely small expense and trouble.

That most fires are preventable can be demonstrated by statistics. An investigation of the approximately 500,000 fires occurring annually in the United States by the Actuarial Bureau of the National Board of Fire Underwriters

CLASSIFICATION OF CAUSES OF DWELLING HOUSE LOSSES



(Reproduced with permission of the National Board of Fire Underwriters)

indicates that about 22 per cent of the fire loss is traceable to strictly preventable causes, and nearly another 38 per cent to causes that are partly preventable. Slightly over 40 per cent of the loss is due to unknown causes which there is good reason, however, to believe, are probably largely preventable. In the case of dwelling house losses, as shown by the accompanying diagram (see p. 298), preventable causes play an even more important rôle. Here 43 per cent of the loss in 1918 is traceable to strictly preventable causes, 34 per cent to partly preventable causes, and 23 per cent to unknown causes which, however, are probably largely preventable.

With respect to the number of dwelling fires traceable to easily preventable causes, the statistics for a large city like Philadelphia, compiled from the published records of the Fire Insurance Patrol of that city, are interesting. During 1919, 2,085 dwelling fires, of known origin, were reported as having occurred in that city. Of this large number 37.26 per cent were traceable to matches. Another 8.30 per cent were attributable to smoking and cigar and cigarette stumps, 7.29 per cent to lamps and candles, 8.58 per cent to gas and gasoline and their appliances, 7 per cent to chimneys and defective flues, and 8.87 per cent to heaters, hot ashes, open grates, ovens, ranges, stoves and rubbish. In other words, these six types of causes occasioned 77.30 per cent, or over three-fourths of all dwelling fires in Philadelphia, of known origin, during 1919. Such statistics clearly indicate that the overwhelming number of fires reported annually are due to carelessness and could easily be prevented.

But an analysis of the causes of fire should do more than call attention to the importance of eliminating indifference and carelessness with respect to the saving of property values. Emphasis should be placed on the danger of loss of life involved in the occurrence of so many fires. Sta-

tistics show that 15,000 lives, 75 per cent of whom are women and children, are burned to death annually in the United States and that several times this number suffer painful injuries from this cause. Moreover, all of the great conflagrations which have taken place in the United States during the last twenty years, have, with only two exceptions, originated from small preventable causes. Emphasis should also be given to the fact that fires—averaging 1,500 a day in the United States—destroy not merely property that is actually burned but result in much inconvenience, loss of profits and customers, and numerous other indirect costs, which in the aggregate probably equal the direct loss itself.

The Essential Factors in Fire Prevention.—The chapter on "Underwriters' Associations" called attention to the numerous ways in which insurance companies are attempting to reduce the nation's fire waste, and these need not be repeated.¹ In fact, the insurance companies' participation in fire prevention is so great that the premium may be regarded in part as payment for expert service in the cause of loss prevention. "It is altogether possible," as reported by a group of experts,² "that in time the premiums will become predominately a price paid for expert prevention of fire." This is as it should be. As observed by the Fire Prevention and Insurance Committee of the Philadelphia Chamber of Commerce: "Very large amounts are freely spent for fire departments, but pitifully small emphasis is given both by way of expenditure and education, to the prevention of the very hazard which occasions such huge public expenditures for fire fighting facilities. It is high time to change our emphasis in this respect. We believe that it is much more efficacious in the long run,

¹ See pages 285 to 287.

² Report of Special Committee on Fire Waste and Insurance of the United States Chamber of Commerce.

from the standpoint of saving property and life, as well as from the viewpoint of public expenditures, to fight the cause of fire rather than merely to fight fire itself after it has started on its course of destruction."

But underlying any real effort at improvement, there must be a substantial coöperation on the part of property owners. Specific attention should be given by them to the following factors:

Management or house-keeping.—Since so many fires are attributable to easily preventable causes, i.e., to carelessness and indifference, the importance of good house-keeping cannot be overemphasized. Our previous statistical explanation clearly shows the importance of having the owner exercise due care with respect to matches, smoking, lamps, gas and gasoline and their appliances, electrical appliances, steam and hot water piping, chimneys and flues, furnaces, ovens and open grates, rubbish, hot ashes, oily waste, the location of dangerous articles, and general cleanliness.

Equipment.—Closely allied to good house-keeping is the installation of good equipment in business establishments and its proper upkeep. Practically every business building must be heated, lighted, ventilated, and equipped with special machinery and apparatus. All of these factors usually involve a fire hazard. It is, therefore, important that the owner should inquire into their quality from a fire standpoint before purchasing, and that he should keep them in a state of proper efficiency at all times. If fire preventive appliances have been installed, it is important that they be cared for properly so that they will work when the emergency arises, i.e., chemical extinguishers should be recharged, fire pails should be filled, fire doors and fire pumps should be tested, and fire hose should be examined periodically.

Construction.—The prevention of the spread of fire, after it has once obtained a good start, depends primarily upon

the construction and planning of the building. From the standpoint of fire prevention, buildings are usually grouped into four main classes, viz., fireproof, semi-fireproof, slow-burning, and ordinary buildings. As regards each of these the greatest care should be exercised in planning the building. Available fire protection, such as fire-service tanks, pumps, boilers, etc., should be considered when determining the height and depth of a building. Elevators and stairways should not be located in inaccessible places, and all communications between floors should be so protected that fire may not seek these avenues in spreading throughout the building. Special hazards, such as the heating plant, should be properly isolated, and light and air should be secured without creating unnecessary exposure and draft. If the nature of the business permits, the risk should also be subdivided into several fire areas, and the most dangerous processes in the business located where they will do the least harm to the rest of the plant or to the stock. With respect to all such factors as the foregoing, the owner should study his insurance rate with a view to ascertaining any possible improvement that will reduce the same.

A so-called fireproof building consists of steel cage construction; and has all of its structural members safely insulated against heat from within or without the building; or they may be of reinforced concrete construction with the reinforcing members properly insulated. All communications between floors for freight or passengers, such as stairways and elevators, are encased in fireproof, cut-off shafts, and all horizontal tiers of windows are fitted with wire glass in fireproof frames. A "fireproof" building is designed so as to isolate each floor from all the others in case of fire, and if used for the storing of combustible materials is so constructed that the contents on any floor may burn with the least danger to the building, and with the least possibility of the fire spreading to other floors.

If the horizontal tiers of windows are not fitted with wire glass, the chances are that a fire on a given floor, since it cannot go up or down, owing to the fireproof construction and the protected floor communications, will be forced out through the windows, and will thus communicate to upper stories through the tiers of windows immediately above.

Semi-fireproof buildings differ from fireproof buildings in that, while constructed of non-inflammable material, they are equipped with structural or tension metal members, which are not properly insulated against heat. These buildings are constructed because of their greater cheapness as compared with fireproof buildings, and because the prevailing building code in many cities does not prevent their erection. They are constructed very often to serve for office purposes or as dwelling apartments, or for other uses of a similar character, in which it is presumed that the limited amount of combustible stock which they contain will make it extremely unlikely that sufficient heat will be generated to injure seriously the ironwork in the building.

Slow-burning or "mill construction" buildings are to be distinguished from semi-fireproof buildings. The floors in slow-burning buildings are without openings, and consist of heavy plank laid on heavy timbers, spaced from 5 to 12 feet apart, such timbers resting on stout wooden posts. It is also prescribed that there must be a tight top flooring, with waterproof paper between it and the plank flooring below, which must never be less than 3 inches in thickness. The aim of such requirements is to separate the different stories by a floor of considerable thickness so that, though large stocks of combustible material may be contained in the building, it will require a considerable time, under normal conditions, for a fire to burn through the flooring. Before this is accomplished it is presumed that the fire department will be able to get the fire under control and prevent its spread.

Occupancy.—As noted in the chapters on fire insurance rates, the use to which a building is put has a very important bearing on the fire hazard to the building. This is illustrated, in the leading rating schedules, by the heavy addition to the unoccupied building rate in order to obtain the rate on the building occupied, whenever the occupancy is of a hazardous nature. Nearly every commodity and process contains certain dangerous elements of fire hazard. These should be studied with particular reference to the building under consideration so that, if desirable from a fire prevention standpoint, they may be properly cared for or isolated.

Protective facilities.—If a fire in the contents of a building is allowed to gain great headway, even a so-called fireproof structure may suffer great damage. The important thing is to extinguish a fire before it reaches large proportions. It is, therefore, highly essential that the owner should equip his building with automatic fire alarm facilities, metal waste and ash cans, chemical extinguishers, fire buckets, stand pipes with ample connections, etc., and, whenever possible, an automatic sprinkler service.

Among automatic devices for extinguishing fires in their incipency special mention should be made of the automatic sprinkler, which operates without the assistance of human effort, applies water almost simultaneously with the outbreak of the fire and in the precise location where needed, and gives to any desired point immediate notice of the existence of the fire.

The device may be described as an arrangement of pipes regularly spaced under all ceilings for distributing water, supplied automatically from elevated tanks, pumps, or city connections, to all portions of a building, and having valves (so-called sprinkler heads for about every 75 to 80 square feet of floor area) so arranged as to open when any undue rise in temperature occurs. The arrangement

of the valves, so as to open with a rise in temperature, is brought about by having the joints soldered with fusible metal which will melt with increasing temperature and release them as soon as heated. The fusible solder used is, for the sake of convenience, adjusted for different temperatures, varying from 165 to 365 degrees, according to the nature of the risk to be protected. When in operation, a single sprinkler head will, at 30 pounds pressure, discharge a fine spray at the rate of about 30 gallons a minute.

The automatic sprinkler is the only device known which meets all the conditions necessary to quench a fire in its incipency. It thus overcomes the old and defective method of trusting to human eyes to detect a fire in time, and to human hands in extinguishing a fire after it is discovered. Fire underwriters are generally agreed that the device is by far the most reliable and effective of fire fighting agencies. Thus, the bulletin of one leading manufacturer of automatic sprinklers presents the benefits of the device as shown by the record of 22,827 fires in risks equipped with sprinklers, and extending over a period of many years. Of this number there were only 7,224 fires of sufficient size to warrant a claim being made. The average loss per fire in these sprinklered risks was only \$315 as compared with an average loss of \$7,361 per fire paid by the New England Mutual Insurance Companies prior to the introduction of sprinkler protection. Such efficiency in preventing large fires naturally justifies a great reduction in insurance rates. In fact, the rate reductions are often so large that the saving in the premium for three or four years will suffice to pay the cost of installation, thus leaving the owner with a paid-for sprinkler system as well as the continuing low insurance rate.

Exposure hazard.—Since insurance rates contain a charge for surrounding exposure hazard to which the insured property is exposed, it follows that the owner should

study this factor with a view to reducing the charge. A very material reduction may usually be secured through the betterment of a building by equipping it with fire-proof windows and doors, non-combustible roofs, fire walls extending above the roof, automatic sprinkler service, etc.

Necessity for Fire Prevention Education in the Schools.

—Educational efforts of insurance companies along specialized lines should, of course, be continued to the utmost.³

But it is also essential that the great mass of our people should be instructed in the elements of fire prevention through our school system with a view to reaching the great underlying cause of fire, viz., carelessness and indifference. Systematic fire prevention education in the schools will accomplish much more in the long run than voluntary education which can reach only a limited number at best.

The above suggestion contemplates that the educational authorities should arrange to have fire prevention education introduced in the school systems of their respective communities.⁴ It is encouraging to note that several states

³Chapter XV on "Underwriters' Associations" outlines the collective effort of insurance companies with respect to education through the preparation and distribution of a national building code; standard specifications for the proper installation of lighting, heating and ventilating systems; and scores of handbooks dealing with fire preventive appliances, fire retarding materials, and types of construction.

⁴For the purpose, an excellent fire prevention manual is now at hand. It was prepared for the United States Bureau of Education by the National Board of Fire Underwriters. It is now in use in many communities, while its use in numerous other communities is under contemplation. Its 91 pages of text, with over 100 illustrations, present in simple language and in a very interesting and forceful manner practical instruction designed to stimulate interest in fire prevention.

The manual is adapted for use in the seventh and eighth grades; but until such education has become a permanent part of our school system, and in order to reach the largest number of pupils immediately, it is suggested that its contents be conveyed to students above the indicated grades. Separate chapters of the book, all

have already arranged to follow such a policy, and that others are contemplating similar action. Fire prevention may easily be made the means of stimulating the students' mind and power of expression in a way fully commensurate with the service rendered in this respect by other subjects now in the curriculum. Teachers will find that the subject will arouse a genuine interest in their students and will inculcate in them a real sense of responsibility as well as proper habits of carefulness at the very time when habits are formed. This sense of responsibility and this habit of carefulness, when class after class has been imbued with them, will redound to the great good of the community. Pupils may also be required to apply a fire prevention inspection blank to their homes, the same when filled out to be returned to the teacher. The great value of self-inspection as a developer of habits of carefulness and responsibility need not be emphasized. This suggestion may be applied conveniently in conjunction with the use of some elementary text. In ever so many instances the young inspectors will, when inspecting their own homes along the lines suggested by their course of study, call their elders' attention to many derelictions.⁵

Necessity for Public Regulation.—Past experience has clearly demonstrated that preventable fires cannot be avoided solely through voluntary action on the part of owners and tenants. The appeal to self-interest has its serious limitations, and fire prevention experts are thus

full of useful advice, are devoted to each of the following essential phases of good housekeeping, namely, matches, lights, stoves and furnaces, cooking and cleaning, disposal of rubbish, containers and caring for kerosene, gasoline, electrical devices, etc., smoking, pyroxylin plastic, safety rules for holidays, and "the first five minutes."

⁵ All the foregoing educational suggestions were recommended for introduction in the school system of Pennsylvania by the Fire Prevention and Insurance Committee of the Philadelphia Chamber of Commerce.

recommending the imposition of positive requirements. Among the leading recommendations of this character are the following:

(1) General adoption of a law creating the office of fire marshal, and investing him with definite duties and powers relating to the making and enforcement of regulations governing (1) the manufacture, sale and storage of very hazardous articles, (2) the proper repair of dangerous structures, (3) the installation of proper fire extinguishing and fire alarm apparatus in certain cases, (4) the removal of rubbish and dangerous materials, and (5) the investigation and reporting of the origin and circumstances surrounding fires.

(2) General adoption and enforcement of good building ordinances providing for the proper construction and maintenance of buildings, and their periodical inspection by some designated official vested with power to enforce his recommendations.

(3) Adoption of laws or ordinances providing for the licensing of occupancies, and the granting of permits for the use of extra hazardous materials and processes.

(4) The compulsory introduction of automatic sprinklers in the basement of manufacturing, mercantile and storage buildings of large size, as well as in public schools and apartment houses, unless the basement ceiling is of concrete or similar non-combustible material with no openings between the basement and other floors. Similarly, it is recommended that ordinances be passed in our leading cities requiring full sprinkler protection throughout a building if extra hazardous conditions exist.

(5) Utilization of various public departments for service in preventing fires. Thus a fire department's personnel may be used to inspect the buildings within its particular jurisdiction. Such inspections will not only reveal conditions that should be corrected, but will educate the fire

fighters in all the physical details of the buildings which they may be called upon to protect. Again, the personnel of the police department may be used to inspect all homes with respect to rubbish and other similar matters vital to fire prevention.

(6) The application of a graduated scale of fines upon the responsible parties—increasing as the number of offenses increases—for fires caused by gross carelessness. This practice is in general use in many foreign countries and has proved very effective. The public welfare with respect to the prevention of loss of both property and life justifies the application of this method as a fair and reasonable restraining influence.

Individual liability to neighbors for damage caused by fires due to gross carelessness would also prove exceedingly effective as a cure for present conditions. Although the common law provides for such liability, there has been little effort in the United States, except with regard to certain corporations like railroad companies, to enforce personal responsibility for fire damage to others. In certain European countries personal liability for damage from fire occasioned by negligence is imposed by statute law. In the United States, however, the idea has not progressed beyond the hearty endorsement of the nation's leading fire prevention experts. A person whose unnecessary fire has damaged a neighbor's property has done an unneighborly act. The rule of imposing legal liability should certainly prove very educative. While the idea of imposing personal responsibility may seem too revolutionary for adoption at this time, the suggestion is worthy of careful thought.

CHAPTER XXI ✓

STATE SUPERVISION AND REGULATION

Full Supervisory Control Over Insurance Possessed by the Several States.—Beginning with the famous case of *Paul vs. Virginia*,¹ decided in 1868, the United States Supreme Court has again and again asserted the doctrine “that there is no doubt of the power of the state (using that term as contrasted with the Federal Government) to prohibit foreign insurance companies from doing business within its limits. The state can impose such conditions as it pleases upon the doing of any business by these companies within its borders, and unless the conditions be complied with the prohibition may be absolute.”

Because of its broad jurisdiction over all foreign relations, the United States government, in theory at least, possesses the power to exclude or expel alien corporations from all parts of the country; likewise to admit them without regard to the regulation of the states. In actual practice, however, an alien insurance corporation wishing to do business in the United States first seeks admission to a certain state. By complying with its laws it establishes therein its headquarters for American business; and then, if business warrants, seeks admission

¹ *Paul vs. Va.*, 8 Wall., 168 (1868). Also see *Liverpool Co. vs. Mass.*, 10 Wall., 566; *Hooper vs. Cal.*, 155 U. S., 684; *N. Y. Life Ins. Co. vs. Cravens*, 178 U. S., 389 and *Nutting vs. Mass.*, 183 U. S., 553. The Supreme Court has decided that insurance may not be regarded as an “article of commerce.” It, therefore, follows that insurance does not come within the control of the Federal Government, and is relegated to the legislative and supervisory powers of the several States.

to other states. Indeed, to such an extent has the jurisdiction of the several states over alien insurance companies been recognized that the Executive Department of the United States has not seen fit, in the absence of a treaty stipulation covering the subject, to consider a complaint of unjust discrimination lodged by an alien company against a state, and has expressed the view that the regulation of insurance corporations by federal treaty would not be sanctioned by the representatives of the states.

Acting in accordance with the numerous decisions of the United States Supreme Court, the several states and territories of the United States, including the District of Columbia, have each assumed full supervisory powers over all alien, foreign and domestic corporations transacting an insurance business within their borders. In all except eight of the states and territories this control has been entrusted to a supervisory officer, known as the Superintendent or Commissioner of Insurance, who, in nearly all cases, is appointed by the Governor, and is placed in charge of a separate department of the state government. In a number of states the responsibility of supervising insurance companies is still attached to some other Department of Government. Thus, in three states, at the close of 1921, supervisory control was exercised by the State Treasurer, in two by the Secretary of State, and in three by the State Comptroller or Auditor.

Powers of the Insurance Commissioner.—Although the legislatures and courts of the several states, as we have seen, play a prominent part in the enactment and interpretation of insurance legislation, the actual supervision of the companies and the enforcement of the laws is performed by the insurance commissioners. These officials, to say the least, are vested with extraordinary powers

in the matter of application. Among other things, the commissioner of insurance must see to it that all the laws of the state respecting insurance companies and the agents thereof are faithfully executed, and that the companies are in a solvent condition according to some fixed standard. No foreign company may transact business within the state without his permission, and no person may solicit business for such companies without the commissioner's certificate of authority. Every company must render an annual statement of its condition and business in the form and manner prescribed by the commissioner. He is also given power to require at any time statements concerning any company doing business in the state, from any of its officers or agents on any points he may choose to ask. For purposes of examination, he is empowered to require free access to all books and papers of any insurance company within the state, or the agents thereof, doing business within the state. He may summon and examine any person under oath relative to the affairs and condition of any company; and for probable cause may visit at its principal office, wherever it may be, any insurance company not of a state in which the substantial provisions of the law of his own state shall be enacted, and doing business in the state, for the purpose of investigating its affairs, and may revoke its certificate if it does not permit such examination. Neglect or refusal on the part of the company to render any statement may mean a cessation of its new business, and neglect to furnish information within the time and manner prescribed by the commissioner usually subjects the company to a money fine.

Power is also given the commissioner to revoke or suspend a company's license if in his opinion it does not comply with any provision of the law, or if its assets appear to him insufficient. He must see that the company

has made the proper deposits of approved securities; that it makes a correct return of the taxes which are imposed by law; and that a resident of his state is appointed the attorney of the company so that in the event of litigation legal process may be served without the citizens being obliged to go outside of the state to serve the papers. It is also his duty to calculate the reserve for unexpired risks, and to see that the assets of all companies organized in the state are properly invested in the form prescribed by law. He has supervisory powers over the organization of all companies from the time that the articles of agreement are arranged until the company is ready to begin the writing of policies, and in every stage of the organization and in all matters pertaining thereto it is necessary for the organizers of the company to have his approval. Finally, he owes it to the public as well as to the insurance companies to do all in his power to exterminate improper or unlawful insurance schemes or practices. Numerous other duties and powers might be enumerated, but those mentioned will suffice to show that the insurance commissioner is clothed with extraordinary powers, and that consequently the personality of the commissioner is a factor, the importance of which cannot be overestimated.

Regulation of Insurance by Statute.—Few business enterprises, if any, are so thoroughly regulated by statute as insurance. In fact, the law of most leading states is so voluminous as to constitute a separate code. While space limits forbid a description of all the numerous subject-matters dealt with, nearly all of the important legislation affecting fire and marine insurance may conveniently be grouped under the following eight heads:²

² Since the legislative details, such as numbers, amounts, time, etc., vary greatly in the different states, it is suggested that the reader consult the statutes of his own state under each of the head-

1. *Incorporation, organization and operation of companies.*—The laws relating to this subject differ greatly in their details, but resemble each other in the particulars involved and the objects to be attained. It is usual to prescribe by statute the number of citizens who may associate themselves and form an incorporated company. The articles of agreement must specify (1) the name by which the corporation is to be known; (2) the class or classes of insurance for which the company is to be constituted; (3) the plan or principle according to which the business is to be conducted, and the domicile of the company; (4) the amount of the capital stock, if any; and (5) the general object of the company, and the powers it proposes to have and exercise. The name of the company must clearly designate the object and purposes of the company, and in case the associated persons wish to form a mutual company, the word “mutual” must usually appear in the title.

Following the approval of the articles of agreement by the Insurance Commissioner and the Attorney General of the State, the subscribers may proceed to elect their officers. In case the company is a joint stock company, the subscribers must next open books for the subscription of stock in the company, and such books must be kept open until the full amount of stock specified in the certificate is subscribed. Where a mutual company is to be organized, the subscribers to the articles of agreement must open books to receive applications for insurance until such applications have been obtained in sufficient number or amount of insurance to comply with the law. Stock companies are obliged to start with a pre-

ings indicated in this Chapter. Where this book is used as a text, it is also recommended that the teacher assign the insurance statutes of the particular state under consideration with respect to these headings.

scribed minimum capital, varying from \$50,000 to \$400,000, according to the state under consideration; while mutual companies are forbidden to commence writing business until their applications for insurance reach a stipulated figure, usually \$200,000. The par value of the shares of a stock company, as well as the method and time of payment therefor, are also prescribed. As a further protection to policyholders, state statutes usually forbid the payment of dividends except from profits; define the reserve liability;^{*} specify the deposit of certain securities in trust; outline the character of the annual financial reports which companies must submit to the insurance department; and regulate the flotation of additional stock, the reduction of funds by withdrawal, the merger of companies, and the procedure to be followed in the event of the insolvency of the company or the impairment of its capital. Similar statutory regulations, it may be added, are also extended to the admission of foreign (companies of other states) and alien companies, or to the operation of mutual companies, reciprocal associations, or Lloyd's organizations.

2. *Investment of capital, surplus and other funds.*—Besides carefully regulating the organization and operation of the companies, the law of the several states seeks to make the companies safe by carefully regulating the investment of all their funds. The capital of a domestic company, to the extent of the minimum requirement, must usually be invested in (1) federal, state or municipal bonds, or federal farm loan bonds not estimated above their par value or their current market value; (2) bonds or notes secured by mortgages or deeds of trust or improved unencumbered real estate, or perpetual leases thereof, in the United States, worth not less than fifty per centum more than the amount loaned thereon; (3)

^{*} See Chapter XVI on The Reserve.

American railway bonds on which default in interest has not occurred within five years prior to the purchase by the company; and (4) loans upon the pledge of the aforementioned securities. Foreign and alien companies are usually required, to the extent of the minimum capital required of like domestic corporations, to carry investments of the same class as those just described.

The residue of the capital and the surplus funds of every domestic company over and above its capital stock may be invested in or loaned on the pledge of any of the preceding securities; or in the stocks, bonds or other evidences of indebtedness of any solvent institution incorporated within the United States; or in any such real estate as the company may be legally authorized to hold. Companies doing business in foreign countries are usually allowed to invest the funds, required to meet their obligations in such country, in conformity with the laws thereof, in the same kinds of securities in such foreign country as the companies are allowed by law to invest in the United States.

With respect to real estate a company's holdings are usually limited to (1) the building in which the principal office is maintained and the land on which such building stands; (2) such as shall be necessary for the convenient accommodation of its business; (3) such as shall have been mortgaged to it in good faith by way of security for loans previously contracted or for money due; (4) such as shall have been conveyed to it in satisfaction of debts previously contracted in the course of its dealings; and (5) such as it shall have purchased at sales on judgments, decrees, or mortgages obtained or made for such debts. Should any of the real estate specified in subdivisions (2), (3), (4), and (5) be unnecessary for the accommodation of the company in the convenient transaction of its business, the company must dispose

of the same within five years after title has been obtained thereto, unless the superintendent is willing to extend the time on the plea that the company's interest will suffer materially by a forced sale.

3. *Classes of insurance the companies may write.*—

Nearly all the states limit fire and marine insurance companies to those two types of insurance or to such additional forms of protection as may be closely allied. In this country the states have adhered to the so-called "mono-line system," as contrasted with the "multiple line" plan prevailing in England and most European countries. The customary classification with us is three-fold, namely, life insurance, casualty insurance, and fire and marine insurance. As far as possible, American companies are restricted by statute to the writing of some one of these three classes of insurance. British fire and marine companies, on the contrary, have the option of writing practically all forms of insurance, including life, casualty and surety forms.

Any study of the subject will show that the American grouping of insurance coverages is purely artificial and by no means strictly observed. There is already an immense overlapping by numerous companies. Moreover, numerous companies, or those who control them, have been creating subsidiaries to do indirectly what they may not do directly. The multiple line principle, it may be added, has already been adopted by Oregon and Wisconsin to the extent of including all kinds of insurance, whereas on March 4, 1922, the Federal Government recognized the principle with respect to the District of Columbia.⁴

⁴See title II of the Act to Regulate Marine Insurance in the District of Columbia, approved March 4, 1922. For a detailed discussion of the multiple line principle, see S. S. Huebner: Report on "Legislative Obstructions to the Development of Marine Insurance in the United States," pp. 33-40.

By writing various kinds of insurance, it is argued, a company's overhead charges are reduced materially and a reduction in expenditures along many lines is effected. It is also placed in the advantageous position of being able to secure the support of large business concerns by meeting their full insurance needs. Various forms of insurance also complement one another in that bad results in one branch for a series of years are apt to be counter-balanced by good results in some other branch. British companies have found the privilege of multiple line insurance a great source of strength, especially in that such freedom has greatly helped them to capture the foreign market by enabling them to meet the full insurance needs of large foreign corporations. Largely because of this fact, American marine underwriters have requested that they be also permitted to adopt the department store idea in insurance directly.

Marine insurance as practiced to-day, it should be pointed out, is essentially multiple in character. It protects against fire, perils of the sea, and a multitude of other hazards. It embraces builders' risk insurance, which covers every variety of hazard connected with the process of constructing and repairing vessels. It also includes protection and indemnity insurance, involving some thirteen distinct kinds of risk, including injury to crew, passengers and other persons, theft and pilferage, property damage to vessels, cargo, piers, etc., illness of passengers and seamen, and negligence or default of the carrier, captain or crew. American marine companies, judging from their answers to an inquiry as to why they did not emphasize certain types of insurance, are prevented by state law in many instances from writing even such closely allied forms of protection as builders' risk and protection and indemnity insurance. Fifteen insurance commissioners have advised that the statutes of their

states will not allow marine, and fire-marine insurance companies to write protection and indemnity insurance; thirteen expressed themselves to the same effect with reference to builders' risk insurance; and five more were uncertain, but expressed grave doubt with respect to both of these forms of insurance.

4. *Taxation of insurance companies.*—The great majority of states subject fire, marine and fire-marine companies to a tax on gross premiums derived from business within the state (after deducting return premiums and premiums paid for reinsurance in authorized companies), ranging all the way from 1 to 3 per cent. An examination of the laws, however, indicates the utmost lack of uniformity in the rates and the methods of taxation used. The situation is rendered still more complicated by the fact that many states apply different methods of taxation, or different rates if the method is the same, to domestic companies from those applied to foreign and alien companies.

With respect to domestic companies 36 states tax premiums (derived within the state and after deducting either return premiums or premiums paid for reinsurance in authorized companies or both such return and reinsurance premiums) in one form or another. Ten states impose a tax of 2 per cent on gross premiums after deducting return premiums and premiums for reinsurance placed with authorized companies; in four states the tax on this basis is 1 per cent, in three $1\frac{1}{2}$ per cent, and in three other states $2\frac{1}{4}$, $2\frac{3}{8}$, and $2\frac{6}{10}$ per cent, respectively. Three states tax domestic companies $2\frac{1}{2}$ per cent on gross premiums after deducting only return premiums, while in three other states the tax on this basis is 2 per cent and in one state $1\frac{1}{2}$ per cent.

Mention should also be made of the facts that a number of states impose upon fire and marine insurance

companies, in addition to their other taxes, a flat or percentage franchise tax, and that in a number of other instances the state taxation is reduced by degrees in accordance with the extent to which the company invests its funds within the state under consideration. With respect to the taxation of foreign and alien companies, 27 states apply the same method and rate of taxation as are applied to domestic companies. Nearly all the remaining states charge admitted companies of other states or foreign countries a higher rate than is imposed upon their own companies.

In addition to all the aforementioned taxes, insurance companies are subjected to a large variety of state license fees and special charges, relating to the organization of companies, the annual licensing of companies and their agents, the filing of reports and other papers, the certification and publication of annual statements, etc. Here, again, the utmost lack of uniformity presents itself with respect to the requirements of different states. A careful tabulation of such licenses and fees reveals a list of 47 varieties to which a company would be subject if entered in all the states.

To make sure that insurance companies will be treated with equal severity, it is interesting to note that 38 states have "retaliatory laws" on their statute books, although it is customary to refer to such laws with the more charitably sounding title of "reciprocal legislation." The nature of the reciprocity is indicated by the following customary wording of such statutes:

When, by the laws of any other State, any taxes, fines, penalties, licenses, fees, deposits of money or securities, or other obligations or prohibitions are imposed upon insurance companies of this or other States, or their agents, greater than are required by the laws of this State, then the same taxes, fines, penalties, licenses, fees,

and other obligations and prohibitions, of whatever kind, shall, in like manner, for like purpose, be imposed upon all insurance companies of such States and their agents.

All of the 38 aforementioned retaliatory laws apply to deposits of money or securities; all except two refer to taxes, fines, and fees; while in 24 instances the statute extends the retaliatory feature to cover "any obligations, prohibitions and restrictions."

The collective burden involved in all of the aforementioned taxes and fees gives unmistakable evidence of excessive and unjust taxation, especially when the Federal taxes are added. A compilation shows that 71 American marine and fire-marine companies paid a total of \$19,500,429 of taxes and fees during 1918. Of this total the Federal Government collected \$8,964,030 and the state and local governments, \$10,536,399. With respect to the marine insurance of these companies, taxes and fees amounted to 6.18 per cent of the total net marine premium income of the companies, while for fire insurance the percentage was 4.76 per cent. Yet leading underwriters have testified that they are satisfied to make, over a period of years, an underwriting profit equal to 5 per cent of the net premium income. Total taxes and fees paid during a single year by these 71 companies amounted to nearly 22½ per cent of their capital stock, and to nearly 8 per cent of the capital stock and surplus combined. For every dollar of dividends paid by these companies to their stockholders during the year, the tax-gatherer took nearly \$1.06.

The American system of premium taxation, it is contended, is unscientific, to say the least, and can be supported only on the plea of revenue and ease of collection. British taxation, on the contrary, is levied on net profits and recognizes the fact that a premium written may never-

theless result in a loss. Taxation of premiums fails to make any allowance for loss payments and legitimate expenses of operation. During the recent Congressional investigation of marine insurance, American companies were a unit in insisting that their taxes, in view of foreign competition, should also bear a proper relation to the profits made. The Federal Government recognized this plea and in the law of March 4, 1922, wiped out premium taxation with respect to marine insurance in the District of Columbia, and substituted therefor a system of net profits taxation.⁵

5. *Reinsurance*.—State statutes relating to this subject were summarized in the Chapter on Reinsurance, and need not be repeated. As there explained, American legislation relating to the subject has been narrow, unduly restrictive, and much out of harmony with the needs of modern business for reinsurance facilities which will serve the purpose adequately and automatically.

6. *Regulation of agents and brokers*.—This subject comprises a very large portion of American insurance legislation. Besides defining the legal status of agents and brokers with respect to both insurer and insured, the law outlines their duties and qualifications and provides for their licensing by the Commissioner of Insurance. They are usually held personally liable on all contracts of insurance unlawfully made by them for, or on behalf of, any company or association not authorized to do business in the state under consideration. Penalties are also imposed on agents for (1) transacting business for unauthorized companies; (2) representing or advertising themselves as the representatives of unauthorized or fictitious companies; (3) re-

⁵See title V of the Act to Regulate Marine Insurance in the District of Columbia, approved March 4th, 1922. Also see S. S. Huebner: Report on "Legislative Obstructions to the Development of Marine Insurance in the United States," Chapter III on "The Tax Burden."

bating either directly or indirectly; (4) embezzling any of the company's funds; and (5) issuing any false or misleading estimates or incomplete comparisons.

7. *Enforcement of standard policy provisions.*—As previously noted, the standard fire policy has been adopted as a statute by most leading states. Such statutes, in addition to specifying all the provisions of the contract, impose penalties for any violation. An increasing number of states have also enacted laws regulating all fire rate making bureaus.*

8. *Imposition of liability for causing fires.*—A considerable number of states impose personal liability, in cities of certain classes, for the cost of extinguishing fires which occur through criminal intent, design, or willful negligence, or where there has not been compliance with any law, ordinance, or other lawful regulation for the prevention of fire or the spreading thereof. To an increasing extent, also, the leading states are creating the office of state fire marshal. The statute, creating the department, usually defines the powers and duties of the office; provides for the investigation of the cause, origin, and circumstance of fires, and the inspection of all risks and the removal or change of certain buildings; imposes duties on school authorities and on certain corporations, associations and fire underwriting agencies; and provides for the attendance of witnesses before the department, and the enforcement of its orders.

* See pp. 288, 289.

PART II
MARINE INSURANCE

CHAPTER XXII

TYPES OF MARINE INSURANCE POLICIES

Definition of Marine Insurance.¹—The purpose of marine insurance is to indemnify interested parties against loss, damage, or expense occasioned accidentally in connection with vessels, cargoes, and freight charges through any of the numerous perils incident to transportation by water. As will be explained in later chapters the modern marine insurance policy affords a very broad protection. Competition, in fact, has been responsible for the assumption by underwriters of nearly every conceivable hazard that may cause fortuitous loss to those engaged in commerce. Vessel owners are enabled through marine insurance to protect themselves against loss of hull, freight earnings, and every type of legal liability. The modern "warehouse to warehouse clause" enables goods to be covered from the time they leave the shipper's warehouse in the interior,

¹For a detailed discussion of marine insurance, the reader is referred to William Gow: "*Marine Insurance*"; *A Handbook*, 1913; S. S. Huebner: "*Marine Insurance*," 1920; "*Status of Marine Insurance in the United States*," 1920; "*Legal Obstacles to the Development of Marine Insurance in the United States*," 1920; Frederick Templeman: "*Marine Insurance; Its Principles and Practice*," 1918; and William D. Winter: "*Marine Insurance; Its Principles and Practice*," 1919.

Previous chapters of this volume have contained a discussion of the extent of marine insurance in the United States, its services, the personal character of the contract, the types of marine underwriters, reinsurance arrangements, and underwriters associations. The following six chapters, therefore, will be confined to those phases of the subject not yet discussed, namely, the types of policies, the perils covered, an analysis of the contract, types of losses, special endorsements, and rate making.

through all the various stages of the journey, either by water or land carriers, until they are safely delivered to the warehouse of the consignee. In fact, marine insurance has so extended its sphere of influence in order to meet the needs of modern commerce as to justify its being called "transportation insurance."

Absence of a Standard Policy.—Unlike the practice in fire insurance, no standard form of marine insurance policy is recognized by law in the United States. Most of the companies, it is true, use policies and endorsements which are substantially similar in character. Yet, the differences are sufficiently important to require a thorough familiarity with the contracts of different underwriters on the part of brokers and other buyers of insurance. In the interest of uniformity much more has been accomplished in Great Britain than in the United States. Although not requiring any particular form of policy, Great Britain has codified its marine insurance law in the famous Marine Insurance Act of 1906. All the essential rules governing the writing of marine insurance in Great Britain are carefully defined by this act. Moreover, the act sets forth the Lloyd's form of policy and presents in connection therewith the rules to be observed in interpreting its provisions. (For copy of Lloyd's form of policy see p. 344.)

Introduced several centuries ago, Lloyd's policy still contains the quaint language of earlier days, and in many respects seems poorly adapted to the needs of modern commerce. But whatever may be said against the policy on this score is largely counterbalanced by the advantage of the certainty in meaning and the stability in marine insurance transactions which become possible through the use of a policy which has back of it several centuries of legal decisions, and which has acquired a more and more definite meaning until, to-day, nearly every word it contains has been interpreted by the courts.

It is this desire to have a definitely interpreted contract as the basis of marine insurance transactions that has largely been responsible for the fact that numerous features of Lloyd's policy have been incorporated into American contracts. While a comparison of the different types of policies used in the United States shows that the phraseology varies considerably, a closer examination, whether with regard to vessel or cargo policies, will show that they all have been adapted to the particular risk from a common form—the Lloyd's form—and that despite variations the basic portion of the contract is approximately the same. The only real difference exists in the adaptation of the contract to certain particular conditions, and not in the essential form or content of the document itself.

“Valued” and “Unvalued” Policies.—Marine insurance policies may conveniently be classified into at least fifteen groups or kinds, depending upon the nature of the risk assumed, or the basis upon which the policy is written. Our first classification relates to the presence or absence in the policy of an agreed valuation of the subject-matter of the insurance. When the commodity or vessel is definitely valued for insurance purposes, such as \$50,000 of textiles or a vessel valued at \$500,000, the policy is called “valued” in order to distinguish it from an “unvalued” one where the actual determination of the value of the insured property is deferred to the time of the occurrence of loss or damage. The real difference between the two becomes apparent upon the occurrence of a total loss. In that event, and assuming no deliberate fraud on the part of the insured, the valuation under the valued policy is accepted as the true value, although this may not actually be the case. Under an unvalued policy, on the contrary, the value must be ascertained by the usual methods of adjusting losses. In the case of partial losses, however, there must be, as regards either type of policy, an actual

adjustment of the loss or damage sustained. Fire insurance, as previously noted, rarely presents cases of valued policies, unless so-called valued policy laws in certain states compel their use. In marine insurance, however, the use of valued policies is very general, and probably 90 per cent of all marine insurance is written under that form of contract.

“Voyage” and “Time” Policies.—Voyage policies cover a definitely described voyage (either one way or return), as from New York to Liverpool. Time policies, on the contrary, grant insurance for a stated period of time, usually from noon of a given date to noon of the same date one year hence, and without reference to the number or character of voyages that may take place during the term of the insurance. Voyage policies are most usually written in connection with individual cargo shipments, whereas time policies find their greatest employment in the field of hull insurance, especially where vessels are employed in a regular trade. Under time policies the insured obtains the advantage of permanent protection over a considerable period of time, and is thus relieved of the inconvenience of renewing his insurance for each successive voyage.

“Interest” and “Policy Proof of Interest” Policies.—To be valid, a marine insurance policy must be supported by a legal insurable interest of the insured. In marine insurance, however, it often happens that the insured's interest, although real, is not susceptible of proof in a court of law. Thus, the insured may desire to be protected against the possibility of duty-free articles being placed on the dutiable list, or of existing duties being increased. Or he may desire to have insurance against loss arising out of the possible declaration of war, or out of his failure through marine disaster to earn anticipated freight. Such indefinite contingencies may well constitute the basis of

insurance, and yet be incapable of sufficient proof to obtain legal support in a court of law. Accordingly, it is common, under many circumstances, for underwriters to issue policies that bear definite evidence of the underwriter's willingness to dispense with all proof of interest. Usually such words as "policy proof of interest" (the first letters furnishing the key to the so-called "P. P. I." policies), "interest or no interest," "all interest admitted," "without further proof of interest than the policy itself," etc., are endorsed on the policy. Any such special endorsement is in the nature of an honor agreement and signifies that by common consent the insured is entitled to the payment provided in the policy upon loss of or damage to the subject-matter insured, irrespective of the fact that he has no strictly insurable interest in the same, or is incapable of proving his interest in a court of law. "Interest policies," on the contrary, clearly show that the insured possesses a true and defined interest in the subject-matter of the insurance.

Classification of Hull Policies.—*Policies adapted to the type of vessel.*—Vessels are customarily grouped into four main types, namely, sail, auxiliary sail, steam, and power boats. Each of these particular classes presents its peculiar problems to the underwriter and these must be met with the use of especially adapted policies and endorsements. A further classification depends on the nature of the waters navigated or the particular use served by the vessel in question. Thus there are policies labeled as "steam boat only," "tug," "yacht," "whaling and fishing," "canal hull," "schooner," "barge," "lighterage," "lakehull," "river hull," "Great Lakes and river traffic," etc. While these various policies resemble each other in their general form and essential features, there are, nevertheless, important differences, especially by way of additional clauses designed to adapt the insurance to the vary-

ing conditions that prevail in the given trade or with respect to the particular vessel under consideration.

Fleet insurance.—One of the noteworthy tendencies in modern commerce is the ownership and operation of vessels in large fleets. With this development it became desirable to insure a fleet as such instead of effecting insurance separately on each individual vessel constituting the fleet. Several reasons have caused such fleet insurance to assume very large proportions in recent years. It is manifestly a great convenience to have a score or more of vessels covered on time under a single policy. In this way millions of dollars of insurance may be treated as a single account for distribution on a share or participation basis among twenty, fifty, or even more companies. As a rule, more favorable rates of premium are also obtainable under this method. Individual vessels, if inferior, may be declined altogether or, if accepted, may be underwritten at very high premiums. As explained elsewhere: "A fleet of vessels has usually been built up in the course of a considerable number of years, and thus represents an average of old and new or good and inferior vessels. If the vessels composing the fleet are considered separately, the underwriter will naturally be inclined to accept the good and avoid the inferior. But under fleet insurance he is confronted with the proposition of insuring 'all or none.' His privilege of free choice as between the vessels is limited. He will thus accept the entire fleet either as an individual or in conjunction with other underwriters. But his retained line will necessarily be limited to a certain percentage only, the balance being spread over other underwriters on some share or participation basis. The rate will be uniform for all the insurance on the fleet, and will probably be arrived at by segregating the vessels of the fleet into groups and applying the premium on each group, the final premium being the sum of the several group

rates.”² Certain brokers, it may be added, sometimes even combine several fleets into a single insurance account, with the object of compelling underwriters to accept all or none. In this way, according to their assertions, they often manage to get a poor fleet insured at a rate more favorable than could otherwise be obtained.

“Full form” and “total loss only” policies.—It is customary for vessel owners to cover a considerable part of the value of their vessels—often from 25 to 40 per cent—under “total loss only” policies, since it is quite improbable that any partial loss will ever be large enough to affect any value in excess of the percentages indicated. Such total loss only insurance is quoted at rates equal only to about one-third of the rates quoted for “full form insurance,” i.e., for insurance which also covers against partial losses. Partial losses, it should be stated, are much more numerous than total losses, and in the aggregate represent more than twice the loss attributable to total losses. The practice of insuring against total loss only may be necessary at times, in order to obtain a favorable rate when the inferior condition of the vessel would cause the premium on full coverage insurance to be exceedingly high. Again, sufficient full coverage may be difficult to obtain on vessels of very high value, and accordingly the final lines of insurance are placed on the “total loss only” plan. But to protect underwriters issuing full coverage contracts, it is usually found necessary to limit the amount of total loss only insurance to a stipulated percentage of all the insurance carried.

“Port risk only” policies.—When a vessel is confined to a port for a long period, owing to unemployment or necessary extensive repairs, the owner may find it advantageous to carry a “port risk only policy,” instead of insurance

² See S. S. Huebner: “Marine Insurance,” p. 116.

which also covers the hazards of navigation. Since such hazards are not present, it is apparent that the rate of premium on port risk policies is considerably lower than on full form policies. The premium is usually charged on either a monthly or annual basis, and if the latter, the insured is usually given the privilege of cancellation on the basis of a published short rate table. As a rule, the policy covers all hazards to which the vessel might be subject while in port, including fire, collision, damage to machinery, and the risks attaching to the transfer of the vessel from one dock to another, or of placing it in dry dock for purposes of effecting proper repairs.

Builders' Risk Insurance.³—The so-called builders' risk policy is essentially a shore cover, and relates to the construction or repairing of hulls. Prior to the launching of the vessel the policy covers, to quote its own wording, "all risks, including fire, while under construction and/or fitting out, including materials in buildings, work shops, yards and docks of the assured, or on quays, pontoons, craft, etc., and all risk while in transit to and from the works, and/or the vessel wherever she may be lying, also all risk of loss or damage through collapse of supports or ways from any cause whatever, and all risks of launching and breakage of the ways." Following the launching the coverage extends to all risks connected with the trial trip, "loaded or otherwise as often as required and all risks while proceeding to and returning from the trial course." The only excluded risks provided for are those arising out of (1) workmen's compensation or employer's liability acts, (2) strikes, locked-out workmen, riots or civil commotion, (3) capture, seizure or the consequences of war, (4) consequential damages arising out of delay, and (5) earthquake.

³For a detailed discussion, see S. S. Huebner: "Marine Insurance," Chapter XIII on "Builders' Risk Insurance."

Most of these risks, it will be noticed, can be placed under other types of insurance. At one time builders' risk policies covered property while being conveyed, sometimes over great distances, from the place of manufacture to the shipbuilding yard. To-day, however, the coverage is usually limited to the protection of materials in the port at which the vessel is being built. For an extra premium, however, this exception, and in fact any of the other excluded risks, may be waived by the underwriter.

Protection and Indemnity Insurance.—Under various circumstances vessel owners are subject to legal liability for (1) damage to bill-of-lading cargo entrusted to their custody; (2) injury to passengers, members of crew, or laborers handling cargo; (3) damage to other vessels by collision to the extent of one-fourth of the amount, when this risk is not covered under hull policies; (4) damage to docks, piers, breakwaters, cables, etc., and to property on docks or piers; and (5) illness of passengers or seamen. They also stand to lose through extraordinary quarantine expenses, or damage to other vessels and their cargoes by wash of steamer, crowding other vessels ashore, or causing two or more vessels to collide. Despite their importance, such legal liabilities are not covered by the ordinary marine insurance policy. Hence, vessel owners have associated themselves into ship owners mutuals—so-called protection and indemnity associations—for the special purpose of protecting themselves against loss of this character.⁴

⁴For an account of the services rendered by the American Steamship Owners' Mutual Protection and Indemnity Association, having an enrolled tonnage of eight million tons of shipping, see testimony of Mr. Russell H. Loins in Hearings before the Subcommittee on Marine Insurance of the Committee on the Merchant Marine and Fisheries on "Theft, Pilferage, Non-delivery, Breakage, etc. of Export and Import Shipments," July 18-20, 1921.

Classification of Cargo Policies.—“*Named*” and “*floating*” policies.—When insurance is desired on individual shipments, the consignor or consignee is often unable to ascertain the name of the vessel that will carry the goods. Under such circumstances prompt coverage may be obtained through a so-called “floating policy” which, while specifying the value of the goods, the limits of the voyage and the type of vessel to be used, does not name any particular vessel. Instead, the insurance pertains to any “ship or ships” or “steamer or steamers.” As soon, however, as the insured ascertains the name of the vessel conveying the goods, he must impart that information to the insurer for endorsement on the contract, thus making the policy “named” instead of “floating.”

Open cargo policies.—Probably 90 per cent of all our ocean-going cargo is insured under the so-called “open policy cargo form.” Under this type of policy large shippers are enabled to insure all their shipments, as described in the contract, irrespective of route, time of shipment, or class of vessel. Open policies, in other words, protect all goods afloat, irrespective of definite knowledge on the part of the shipper concerning the important factors surrounding shipments, and thus afford a type of automatic coverage which large scale commerce absolutely needs for its convenient conduct. As a rule, all the lines of vessels that the shipper is likely to use are listed in the policy with respect to their classification for cargo carrying purposes, since this factor enters largely in the determination of cargo rates. The term of the policy is usually for an indefinite period, subject to cancellation by either party on thirty days’ notice. In fact, the writer was shown an instance of an open policy, covering an enormous volume of shipments annually for a large concern, that had been running con-

tinuously for a period of over sixteen years. During the life of the contract the insured is required to report, from time to time, all shipments coming under the description of the policy as they come to his notice, hence the use of the expression "open policy." The premium, depending upon the volume of shipments, is computed from time to time as per a rate schedule attached to the policy. It is thus highly essential that the insured should declare all shipments coming under the protection of the policy, and not merely those on which losses may have been incurred. Underwriters are entitled to collect premiums on the full amount of cargo at risk, and failure to declare any shipments will to that extent deprive the underwriter of the proper premium to which he is entitled. Underwriters also exercise general control over open policies through the use of a valuation clause and the application of a limit of liability as regards any one steamer.

Blanket policies.—Compared with open policies, the blanket form of policy differs principally in the method of computing and paying the premium. Under open policies the premium is based on the amount of cargo actually covered. Under blanket policies, on the contrary, the insured is charged a lump sum premium based on the total amount of cargo which it is estimated will be protected during the term of the contract. If, at the expiration of the policy, the estimated total should prove to be in excess of the cargo actually carried the underwriter agrees to return a portion of the premium, the amount so returned being computed according to the terms of the contract. Should the estimated total fall short of the actual shipments the insured is obligated to pay an additional premium at some agreed rate. Should a loss be paid, it is usually required that there be a reinstatement of the policy for the amount thus paid, together with the payment of an additional premium

equal to the pro rata portion of the annual premium for the unexpired term. Blanket policies prove advantageous to underwriters in assuring them premium payments for the full amount at risk, whereas open policies too often lead to the practice on the part of the insured of failing to report certain shipments coming under the policy. It is also argued that blanket policies are advantageous to shippers in that they do not require the same detailed statement of shipments necessitated under the terms of an open contract.

Transit floaters.—This special type of blanket coverage is used chiefly in our coastwise and inland commerce and is designed to protect local shipments where it would be impossible for shippers constantly to report to underwriters all the numerous items of their shipments. Common carriers also frequently use such contracts to protect shipments entrusted to their custody.

Marine insurance certificates.—Under open policies the insured is usually given the privilege of issuing certificates from time to time on a special form provided by the company. (For sample form of marine insurance certificate see p. 343.) When properly countersigned, these certificates serve as a convenient way of issuing successive negotiable evidences of the insurance itself. In other words, the insured is enabled, as occasion requires, to draw against his insurance account in much the same manner that checks are drawn against a bank account. Marine insurance certificates make unnecessary the issuance of many copies of the policy, i.e., for each individual shipment, loan, or other purpose. Exporters are thus enabled to negotiate a lump sum total of insurance under one policy and then, as occasion arises, to protect their consignees, bankers, or other creditors by issuing to them separate documents which evidence the original policy and which, by transferring to the holder

the benefit of the insurance, act as a substitute therefor.

According to its terms the marine insurance certificate "represents and takes the place of the policy, and conveys all the rights of the original policyholder (for the purpose of collecting any loss or claim) as fully as if the property were covered by a special policy direct to the holder of this certificate and free from any liability for unpaid premiums." Loss, if any, is declared to be "payable to or order, at the office of upon the surrender to them of this certificate, computed at the current rate of exchange on the day of payment, and when so paid liability under this insurance is discharged." By making the loss payable in this manner marine insurance certificates are given the quality of quasi-negotiability. Moreover, insurance companies carry deposits in the most important banking centers in foreign countries, which promptly become available to certificate holders after the loss has been adjusted by the insurer's foreign representatives.

Parcel Post Insurance.—Coverage under this form of insurance extends to goods while in transit by parcel post from the time the property passes into the custody of the post office department for transmission until arrival at the stipulated address. As a rule the policy does not cover merchandise sent on approval. Moreover, merchandise easily susceptible to deterioration is protected only against fire, theft, pilferage and non-delivery. Exemption against loss also exists: (1) where goods are inaccurately or insufficiently addressed, improperly wrapped or packed or on which the postage is not fully prepaid; (2) where the packages bear descriptive labels on the outside which tend to describe the nature of the contents; or (3) where the loss is caused by reason of

war, riots, strikes, etc. The premium per package is graded according to a schedule of values, and it is usually warranted by the insured, "that each package shipped by Government Parcel Post, valued at \$100 or less, will be insured with the Government for not less than \$50."

Registered Mail Insurance.—Under this form of policy the subject-matter of the insurance can be supervised and traced much more readily than is the case with parcel post insurance. For this reason registered mail insurance has proved more satisfactory. During 1920, sixty-one companies collected \$3,203,188 of premiums for this type of insurance. When sending very valuable articles by registered mail, such as currency and securities, underwriters generally insist on the observance of special safeguards. The amount of currency, stocks, bonds, or other evidences of value per registered package is usually limited. Further provision is often made that "the packing and sealing of the package containing the property insured hereunder shall be witnessed by two adults, one of whom shall have charge of same until deposited and registered at the post office." Sometimes it is also provided that a notary public shall count the contents, seal the package and certify to the facts.

Tourist Baggage Insurance.—This form of insurance covers personal effects, when in transit within certain defined geographical limits, "against any and all risks and perils of fire, lightning, cyclone, tornado, flood, navigation and transportation, and theft, pilferage and larceny, provided the insured shall promptly notify the local police authorities on discovery of loss." Some policy forms, however, exclude theft and pilferage altogether, and even where these hazards are assumed the policy usually provides that it does not apply with respect to "the theft, pilferage or larceny of furs, musical and scientific instruments, jewelry, plate and plated ware,

clocks, watches, or similar values for an amount exceeding" a stated percentage of the amount of the policy. Usually the company also protects itself against loss (1) by theft of automobile parts and accessories, (2) "from breakage unless caused by fire, lightning, collision or derailment of the conveyances while on land, or unless caused by the vessel, craft, or lighter being stranded, sunk, burned or in collision while water-borne," and (3) occasioned by delay, inherent defect of the property, or improper or inefficient packing or address. Premium charges vary according to the size of the policy and the number of months comprising the term of the insurance. During 1920, it may be added, fifty-five companies collected \$1,078,143 of premiums for this type of insurance.

Freight Policies.⁵—With a single exception—protection and indemnity insurance—all of the preceding policies relate to the indemnification of loss or damage to vessels, or goods in transit. Freight insurance relates to the third most important interest in maritime ventures, namely, "freight." From an insurance standpoint, this term is defined as the "money payable either for the hire of a vessel or for the conveyance of cargo from one port to another."⁶

When freight is not prepaid the vessel owner or charterer would stand to lose considerably in the event of his failure to complete his part of the contract of carriage. Neither English nor American law recognizes the principle of "distance freight," i.e., payment of freight is conditioned upon the full completion of the contract of carriage, and no compensation whatever is due for a partial completion of the voyage. Accordingly, the owner

⁵ For a fuller discussion of freight policies, see S. S. Huebner: "Marine Insurance," Chapter XII on "Freight Insurance."

⁶ Frederick Templeman: "Marine Insurance; Its Principles and Practice," p. 77.

or charterer of a vessel might have incurred by far the largest share of the expense involved in a long voyage, comprising wages, fuel, food and other provisions. Under such circumstances it is clear that the owner or charterer should have the privilege of securing protection against the contingency of losing on the expenses incurred in case of failure to earn his freight owing to some unavoidable peril. On the other hand, if the freight is prepaid by the shipper under a bill-of-lading which provides for no return in the event of the goods being lost or damaged, it follows that the shipper should also be entitled to full protection against the loss of the amount thus paid. While separate freight policies are often issued to special insurable interests in freight, it is common practice to include the freight interest in the hull policy where the vessel owner or charterer stands to be the loser, or to include it within the cargo policy in the form of an increased valuation of the goods where either the consignor or consignee would be the loser.

SPECIMEN OF MARINE INSURANCE CERTIFICATE

INSURANCE COMPANY

\$..... F No.....

(PLACE AND DATE).....

THIS IS TO CERTIFY, That on.... this Company insured,
under Policy made for.....,

..... Dollars in Gold on

....., valued at

....., shipped on board of the

....., at and from

.....

It is hereby understood and agreed that, in case of loss,
such loss is payable to the order of.....

on surrender of this Certificate, which represents and takes
the place of the Policy, and conveys all the rights of the
Original Policy-holder, (for the purpose of collecting any
claims for loss or damage), as fully as if the property were
covered by a special policy direct to the holder hereof, and
is free from any liability for unpaid premiums.

Not valid unless countersigned under especial authority
given for such purpose.

Countersigned.....

President.....

IT IS ESPECIALLY AGREED, that all claims for loss or damage under this
Certificate shall be submitted for approval to one of the Representatives,
as per list on back of this Certificate, to whom immediate notice of any
casualty must be given.

Claims are to be adjusted according to the usage at Lloyds, but subject to
the conditions of the policy.

Messrs. W. K. WESTER & Co., 2 Lime St. Square, London, England,
are the Attorneys of the Company, to whom service of process can be made.

Notice. To conform with the Revenue Laws of Great Britain, in order to
collect a claim under this Certificate, it must be stamped within Ten days after
its receipt in the United Kingdom.

MARKS AND NUMBERS

CLAUSES

Warranted not to cover the interest
of any partnership corporation, asso-
ciation or person, insurance for whose
account would be contrary to the
Trading with the Enemy Acts, or
other statutes or prohibitions of the
United States.

Warranted free of Capture, Seizure or
Detention as per Policy.

B/L No.

Rate of Premium,..... Amount of Premium, \$.....

COPY OF LLOYD'S FORM OF POLICY

Be it known that

as well in own Name, as for and in
the Name and Names of all and every other
Person or Persons to whom the same doth, may,
or shall appertain, in part or in all, doth make
assurance and cause and them
and every of them to be insured, lost or not lost,
at and from

S. G.
£

upon any kind of Goods and Merchandises, and also
upon the Body, Tackle, Apparel, Ordnance, Munition,
Artillery, Boat and other Furniture, of and in the good
Ship or Vessel called the

whereof is Master, under God, for this present vcyage,
or whosoever else shall go for Master in the said Ship,
or by whatsoever other Name or Names the same Ship,
or the Master thereof, is or shall be named or called,
beginning the adventure upon the said Goods and Mer-
chandises from the loading thereof aboard the said
Ship

upon the said Ship, etc.,

and shall so con-
tinue and endure during her Abode there, upon the
said Ship, etc.; and further, until the said Ship, with
all her Ordnance, Tackle, Apparel, etc., and Goods and
Merchandises whatsoever shall be arrived at

upon the said Ship, etc., until she hath moored at
Anchor Twenty-four Hours in good Safety, and upon
the Goods and Merchandises until the same be there
discharged and safely landed; and it shall be lawful
for the said Ship, etc., in this Voyage to proceed and
sail to and touch and stay at any Ports or Places what-
soever

without Prejudice to this Insurance. The said Ship,
etc., Goods and Merchandises, etc., for so much as
concerns the Assured by Agreement between the
Assured and Assurers in this Policy, are and shall be
valued at

Touching the Adventures and Perils which we the Assurers are contented to bear and do take upon us in this Voyage, they are, of the Seas, Men-of-War, Fire, Enemies, Pirates, Rovers, Thieves, Jettisons, Letters of Mart and Countermart, Surprisals, Takings at Sea, Arrests, Restraints, and Detainments of all Kings, Princes, and People, of what Nation, Condition, or Quality soever, Barratry of the Master and Mariners, and of all other Perils, Losses, and Misfortunes that have or shall come to the Hurt, Detriment or Damage of the said Goods and Merchandises and Ship, etc., or any part thereof; and in case of any Loss or Misfortune, it shall be lawful to the Assured, their Factors, Servants and Assigns, to sue, labor, and travel for, in, and about the Defense, Safeguard and Recovery of the said Goods and Merchandises and Ship, etc., or any part thereof, without Prejudice to this Insurance; to the Charges whereof we, the Assurers, will contribute, each one according to the Rate and Quantity of his sum herein assured. And it is especially declared and agreed that no acts of the Insurer or Insured in recovering, saving, or preserving the property insured, shall be considered as a waiver or acceptance of abandonment. And it is agreed by us, the Insurers, that this Writing or Policy of Assurance shall be of as much Force and Effect as the surest Writing or Policy of Assurance heretofore made in Lombard Street, or in the Royal Exchange, or elsewhere in London.

Warranted nevertheless free of capture, seizure and detention, and the consequences thereof, or of any attempt thereat, piracy excepted, and also from all consequences of hostilities or warlike operations, whether before or after declaration of war.

And so we the Assurers are contented, and do hereby promise and bind ourselves, each one for his own part, our Heirs, Executors, and Goods, to the Assured, their Executors, Administrators, and Assigns, for the true Performance of the Premises, confessing ourselves paid the Consideration due unto us for this Assurance by the Assured
at and after the Rate of

IN WITNESS whereof, we the Assurers have subscribed our Names and Sums assured in

N. B.—Corn, Fish, Salt, Fruit, Flour, and Seed are warranted free from Average, unless general, or the Ship be stranded; Sugar, Tobacco, Hemp, Flax, Hides, and Skins are warranted free from Average under Five Pounds per Cent.; and all other Goods, also the Ship and Freight, are warranted free from Average Under Three Pounds per Cent., unless general, or the Ship be stranded.

CHAPTER XXIII

THE MARINE POLICY ANALYZED

Having explained the various kinds of marine insurance contracts in use, we may next analyze the provisions of a typical policy. The ordinary cargo policy will be used as the basis of such an analysis, essential differences in the hull policy being noted as occasion requires. Moreover, the various provisions will be discussed in the order of their appearance in the contract, with the single exception of the "perils clause" which will serve as the basis for a separate chapter. Although no uniform wording is used by all the companies, the following conditions may be regarded as fairly representative of American cargo policies:

"On Account of" and Payee of the Loss.—

On Account of.....
In case of loss to be paid in funds current in the.....
United States, or in the City of New York to.....

The words "on account of" clearly imply that the insurance may be taken out by an agent of the insured and that the party named is not necessarily the real possessor of the interest. The party named, however, must possess a true interest indirectly, if not directly. Where various parties are interested in the subject-matter of the insurance, as is often the case with open policies, it is highly important that they be designated by name or be sufficiently described. American policies often use the words "for account of whom it may concern," an expression which

also contemplates only the parties for whom the insurance was intended and whom the agent had in mind when negotiating the contract.

Although the policy is usually made payable to the insured, it should be noted that payment may be made to any third party interested in the subject-matter of the insurance. In the case of mortgages on hulls, the policy is usually made payable to the mortgagee and the insured "as their respective interests may appear." Where banks have advanced funds against shipments, losses are usually made payable to the creditors involved. But all claimants to a loss must prove their insurable interest, as well as the amount of the claim, through documentary evidence.

"Lost or Not Lost" and "At and From."—

Do make insurance and cause
to be insured, lost or not lost, at and from
.....

Both of the above-mentioned phrases were introduced in marine insurance policies at a very early date. The term "lost or not lost" is designed to enable the insured to effect insurance under circumstances which might otherwise not be allowable under the law governing insurable interest. Thus a shipment may already have been destroyed at the time insurance is negotiated, although unknown to the applicant for insurance. Or, a vessel or cargo owner may desire to take out additional insurance, although at the time he is unaware of the actual status of the property. Again, the owner may be particularly anxious to secure additional protection, owing to the existence of rumors of loss or damage. But in all such cases the applicant must impart all known information to the insurer, i.e., both parties to the contract must be in possession of the same facts, and the insured must not conceal

any knowledge of actual or probable loss or damage. Even though a known misfortune has occurred, although the extent of the loss is unknown, the insured may protect the balance of the venture against subsequent accidents by warranting the property "free from loss, damage, injury, or expense arising out of casualty of (*date of accident inserted*)."

Turning to the phrase "at and from," it is important to note the difference between insuring a vessel or cargo "from" a port and insuring it "at and from" that port. The first insurance would cover a vessel, for example, only from the moment that it departs on its voyage, while the "at and from" insurance would cover the vessel not only while on the voyage but also at the port of departure before leaving. It should also be noted that a blank space is reserved after the phrase under consideration for a statement of the geographical or time limits of the policy. The beginning of the contract, as regards both time and place should be definitely stated, although the time and place of the termination may be left indefinite provided there is some understanding with respect to the matter. Thus open policies may, as we have seen, be allowed to continue indefinitely; yet there is a definite agreement to the effect that cancellation is permissible by either party subject to a prescribed period of notice, like thirty days, without, however, prejudicing any risk pending at the time of the cancellation. In time hull policies it is the practice to designate both geographical and time limits.

Description of the Subject Matter.—

Upon all kinds of lawful goods and merchandises.

Where the policy insures a definite lot of goods, the marks and numbers should be used to describe the cargo.

In open policies, on the contrary, such general terms as "cargo" or "merchandise" are customarily used, but this is remedied by the specific description of the goods in the shipper's periodic declaration of shipments, required under the terms of the policy. Likewise in marine insurance certificates the use of marks and numbers is very essential in order to have the subject-matter covered by the certificate correspond to the goods described in the bill-of-lading to which the certificate applies. Where special hazards are involved, as in connection with refrigerator goods, live stock, etc., it is essential to declare the specific type of cargo, rather than use such general terms as "goods," "cargo," or "merchandise." Moreover, where deck cargo is to be insured, it is desirable to have the liability definitely assumed by endorsement. In the case of hull insurance, commissions, profits or freight should also be specifically mentioned, if it is desired to have these interests insured. Use of the word "lawful" serves the purpose of guaranteeing the underwriter against the possibility of protecting any kind of illegal traffic. With respect to hull insurance there is also an implied warranty to the effect that the venture must be legal in all particulars.

Description of Vessel and Master.—

Laden or to be laden on board the good.....
called the.....whereof is master for the
present voyage.....or whoever else shall
go for master in the said vessel, or by whatever name or
names the said vessel, or the master thereof, is or shall
be named or called.

In practice, the name of the master is usually not inserted in the blank space provided for the purpose, but the naming of the vessel is essential unless there is an

agreement to the contrary. Manifestly, the character of the vessel and its equipment for the particular cargo or voyage are fundamental to the underwriter in making up his mind as to the acceptance of the risk and the rate of premium to be charged. The word "good" is to be regarded as merely descriptive and not to have reference to the implied warranty of seaworthiness under hull policies. When insuring the vessel, underwriters have the right to assume that it is "seaworthy" in all respects for the intended voyage at the time of starting. As explained elsewhere:¹ "Seaworthiness means that the vessel must be in proper condition. The vessel must be sufficiently coaled and provisioned and must be sufficiently and efficiently manned and officered. It must be 'cargo worthy,' i.e., adapted to carry the particular kind of cargo under consideration. The cargo must be properly stowed and there must be no overloading. And with reference to all of the above particulars the vessel must be rendered seaworthy at the beginning of each distinct stage of the voyage, as, for example, when part of the trip is by river and part by ocean. In cargo policies, however, as distinguished from hull policies, this warranty is not interpreted literally, because an innocent shipper might suffer loss, due to a fault over which he had no control and concerning which he may have had no knowledge whatever."

Beginning and Ending of the Venture.—

Beginning the adventure upon the said goods and merchandises, from and immediately following the loading thereof on board the said vessel, at.....as aforesaid, and so shall continue and endure until the said goods and merchandises shall be safely landed at.....as aforesaid.

¹ S. S. Huebner: "Marine Insurance," p. 14.

The words "from and immediately following the loading thereof on board the said vessel" have been given a technical interpretation, and mean "from the moment the slings of the vessel lift the goods clear of the wharf or other place of deposit."² But underwriters may agree to assume the risk either prior to the loading, or subsequent to the safe unloading, or both. Thus, the "warehouse to warehouse clause" may assume some such wording as the following: "It is understood and agreed that this insurance attaches from the time the goods leave factory, store or warehouse at initial point of shipment, and covers thereafter continuously, in due course of transportation, until same are delivered at store or warehouse at destination, except that on shipments to River Plate Ports the risk hereunder shall cease upon arrival of the goods at any shed (transit or otherwise), store, customhouse or warehouse, or upon the expiry of ten days subsequent to landing, whichever may first occur." At other times, policies are made to cover cargo while on the dock at either the port of departure, or the port of destination, or both.

In the case of voyage hull policies the insurance either commences "from" or "at and from" a port and ends twenty-four hours after the arrival and safe mooring of the vessel at the port of destination. Time hull policies extend from noon to noon of certain stated dates; but should it happen that the insured vessel be at sea at the time of the expiration of the contract, provision is made in the policy for the automatic extension of the insurance until the vessel reaches her port of discharge. When an entire fleet of vessels is insured the contract usually attaches to all of the vessels at the same time, and since

² William D. Winter: "Marine Insurance; Its Principles and Practice," p. 130-131.

it is not to be expected that the fleet will at all times be wholly in port or wholly at sea, it has become the general practice under such policies to ignore the location of the vessels involved.

Deviation.—

And it shall be and may be lawful for the said vessel, in her voyage to proceed and sail to, touch and stay at, any ports or places, if thereunto obliged by stress of weather or other unavoidable accident, without prejudice to this insurance.

This section of the policy specifies the causes that will excuse deviation from the customary route of travel. Underwriters find the permission distinctly beneficial to their interests, since to declare the policy void despite justifiable deviation would often result in masters of vessels acting contrary to their best judgment, thus increasing the chances of loss. In hull insurance, it should be added, underwriters enjoy the protection of an implied warranty which requires that the vessel must proceed in the usual way, directly and without deviation or unnecessary delay, from the port of departure to the port of destination. Failure to comply with this warranty will render the policy null and void. Yet such a result might work great hardships upon cargo owners who have no voice whatever in the management of the vessel. Hence, cargo policies often contain a deviation clause providing that:

This policy shall not be vitiated by any unintentional error in description of voyage or interest, or by deviation, provided the same be communicated to the insurers as soon as known to the assured, and an additional premium paid if required, but it is understood and agreed that this clause does not, in any way, cover the risk of war, riot

or civil commotion, or prejudice the printed wording of the policy excluding risks of this nature.

Valuation of the Subject Matter Insured.—

The said goods and merchandises hereby insured are valued (premium included) at.....

Unlike the practice in fire insurance, the value of cargo and hulls for marine insurance purposes is definitely agreed upon in advance in the overwhelming mass of cases. In the absence of fraud on the part of the insured, it is mutually understood that neither party to the contract will object to the use of the agreed value as the basis for the settlement of a claim, irrespective of the fact that the stated value may actually be below or above the true value. When numerous shipments are covered under one policy the valuation may be settled in advance by agreeing upon a fixed amount per unit of measure, or by declaring that the property should be valued on some such basis as "valued at invoice cost plus 10 per cent plus prepaid or guaranteed freight." For insurance purposes, expensive steamers often have a separate valuation attaching to (1) hull, tackle and furniture, (2) machinery, and (3) especially expensive portions, such as cabin outfits, refrigerating apparatus, etc. The practice of agreeing upon a definite valuation is well adapted to marine insurance. As explained for cargo insurance:⁸

Three main reasons make the valued principle fair and practicable in marine insurance. In the first place, goods are shipped with the expectation of realizing a profit, and to that end the insured incurs many expenses, such as freight, insurance premiums, packing, handling, commissions, customs charges, etc. The value of the

⁸ S. S. Huebner: "Marine Insurance," pp. 54-55.

goods is thus subject to such constant change that it is generally impossible for the shipper to know in advance what the real value will be at the time of loss. It would therefore seem to be only fair, barring cases of fraud, to permit the parties to agree upon a fair value and to promise the insured that he may rely upon this value as the only one to be considered in the settlement of a claim. In fire insurance such a policy is clearly undesirable, because of the moral hazard. Here the insured has custody and control of the property, and is in a position, should he succeed in overvaluing his interest, to bring about its destruction. But in marine insurance the cargo is not in the custody or control of the insured, and he cannot destroy the same except through collusion with the carrier or other custodian. Moreover, it is always desirable to reduce the prospects of litigation to a minimum. Needless to say, the valued principle helps to accomplish this purpose, and serves to eliminate needless friction and to create a stronger feeling of confidence in the mind of the insured.

Sue, Labor and Travel Clause.—

And in case of any loss or misfortune it shall be lawful and necessary to and for the assured..... factors, servants, and assigns to sue, labor, and travel for, in and about the defense, safeguard and recovery of the said goods and merchandises, or any part thereof, without prejudice to this insurance; nor shall the acts of the insured or insurers, in recovering, saving, and preserving the property insured, in case of disaster, be considered a waiver or an acceptance of an abandonment; to the charges whereof, the said Insurance Company will contribute, according to the rate and quantity of the sum herein insured.....

This clause applies after a loss or misfortune has occurred, and has for its purpose the preservation of the

property against unnecessary loss through prompt action on the part of the insured. In return for his efforts, the insured is promised (1) reimbursement for all expenditures incurred in the proportion that the insurance carried bears to the value of the property at risk, and (2) that no act in defending, safeguarding or recovering the property shall in any way prejudice the insurance or be considered a waiver or an acceptance of an abandonment. The clause, it should be noted, is highly important in all cases where loss is due to the fault of third parties, since it requires the insured under such circumstances to undertake himself the enforcement of all remedies at law.

◀The Consideration.—

Having been paid the consideration for this insurance by the assured or.....assigns, at and after the rate of.....

Rates of premium are based on a unit of insurance of \$100 in the United States and £100 in England and are usually stated in the margin of the policy. Unlike the practice in fire insurance, marine insurance policies usually make no provision for a return premium in the event of cancellation. In fact, the policy usually provides in another section that "if the voyage aforesaid shall have been undertaken and shall have terminated before the date of this policy, then there shall be no return of premium on account of such termination of the voyage." The courts have taken the view that a marine insurance policy is an indivisible proposition, and that it is unfair to consider the hazard the same at one time as another and thus apportion the premium day by day and month by month. Since the policy is regarded as indivisible, it follows that the premium paid therefor is likewise indi- ✓

visible, unless the insurer expressly agrees to the contrary.

Settlement of the Loss.—

And in case of loss, such loss to be paid in thirty days after proof of loss, and proof of interest in the said (amount of the note given for the premium, if unpaid, being first deducted), but no partial loss or particular average shall in any case be paid, unless amounting to five per cent.

Before the loss is paid the insured is required to fulfill two conditions, namely, present (1) his proof of loss, and (2) his proof of interest. The first consists of the "protest," which is a sworn statement made by the master and a part of the crew (usually made before a notary public if at a domestic port, or before a consul if at a foreign port) in which they explain the circumstances and perils under which the loss occurred. A survey, made by a sworn surveyor of the port, or some other disinterested expert, or an examination of the log of the vessel, may also accompany the protest. "Proof of interest" consists of the documents necessary to prove the nature and extent of the insurable interest. In hull insurance it consists of the register of the vessel recorded in the Customs House, while in cargo insurance it comprises the invoice (showing the value) and bill-of-lading (showing that the goods were on the vessel) and an affidavit of the insured in which he declares that he actually possesses the interest claimed in the subject-matter of the insurance. The policy or the certificate of insurance, as the case may be, is also presented. The five per cent deduction provided for at the end of this section is similar to the "memorandum clause," and will be discussed under that heading.

Double Insurance Clause.—

(For an explanation of this clause, see pages 139 and 140.)

Capture, Seizure, Detention, Blockade or Prohibited Trade.—It is also agreed, that the subject-matter of this insurance be warranted by the assured free from loss or damaged caused by strikers, locked out workmen or persons taking part in labor disturbances, or arising from riot, civil commotion, capture, seizure, or detention or from any attempt thereat or the consequences thereof, or the direct or remote consequences of any hostilities, arising from the acts of any government, people, or persons whatsoever (ordinary piracy excepted), whether on account of any illicit or prohibited trade, or any trade in articles contraband of war, or the violation of any port regulation, or otherwise. Also free from loss or damage resulting from measures or operations incident to war, whether before or after the declaration thereof.

In the event of risk of war being assumed by endorsement under this policy, the assured warrant not to abandon in case of capture, seizure or detention, until after the condemnation of the property insured; nor until ninety days after notice of said condemnation is given to this Company. Also warranted not to abandon in case of blockade, and free from any expense in consequence of detention or blockade; but in the event of blockade, to be at liberty to proceed to an open port and there end the voyage.

This group of clauses exempts underwriters from four types of losses. The first paragraph excludes loss or damage resulting from (1) labor disturbances, riot, or civil commotion, (2) capture, seizure, detention or hostilities, "on account of any illicit or prohibited trade, or any trade in articles contraband of war, or the violation of any port regulations," and (3) war hazards. In case the underwriter assumes the war hazard, the insured

agrees not to "abandon" the property in the event of capture, seizure or detention until after the property has been condemned. In the absence of such a clause, the insured could simply regard the insured property as a total loss and "abandon" it (i.e., transfer all his rights in the insured property) to the underwriter, and demand full payment of the insurance. The last sentence contains two additional thoughts, namely, (1) that the underwriter is free from any expense in consequence of capture, seizure, detention, or blockade, and (2) that in the event of blockade the insured is at liberty to proceed to an open port and there end the voyage.

The Memorandum Clause.—

It is also agreed, that bar, bundle, rod, hoop, and sheet iron, wire of all kinds, tin plates, steel, madder, sumac, brooms, wicker ware and willow (manufactured or otherwise), straw goods, salt, grain of all kinds, rice, tobacco, Indian meal, fruits (whether preserved or otherwise), cheese, dry fish, hay, vegetables, and roots, paper, rags, hempen yarn, bags, cotton bagging, and other articles used for bags or bagging, pleasure carriages, household furniture, skins and hides, musical instruments, looking glasses, and all other articles that are perishable in their nature, are warranted by the assured free from average unless general; hemp, tobacco stems, matting and cassia, except in boxes, free from average under 20 per cent, unless general; and sugar, flax, flaxseed and bread, are warranted by the assured free from average under 7 per cent, unless general; and coffee in bags or bulk, pepper in bags or bulk, free from average under 10 per cent, unless general. Profits warranted free from claim for general average, but subject to same percentum of partial loss as if the insurance were on goods. In case a total loss of profits be claimed, the underwriters to be entitled to a credit of the same percentum of salvage as if the insurance were on goods, and in case of contribu-

tion in General Average for any portion of the goods at the customary sound value, this Company to be free from claim for loss on such portion. Not liable for loss arising from wet, breakage, leakage or exposure of goods shipped on deck.

Frequently the following paragraph is also made a part of the memorandum clause:

Warranted by the insured free from damage or injury, from dampness, change of flavor, or being spotted, discolored, musty or moldy, except caused by actual contact of sea water with the articles damaged, occasioned by sea perils. In case of partial loss by sea damage to dry goods, cutlery or other hardware, the loss shall be ascertained by a separation and sale of the portion only of the contents of the packages so damaged, and not otherwise; and the same practice shall obtain as to all other merchandise as far as practicable. Not liable for leakage of molasses or other liquids, unless occasioned by stranding or collision with another vessel.

Some such "memorandum clause" as the foregoing is found in nearly every cargo policy. It may be defined as an enumeration of commodities, arranged in groups, concerning which there is a limitation of the underwriter's liability for "particular average," i.e., for partial losses resulting from accident, as distinguished from "general average losses" that are incurred at the command of the master of the vessel in time of distress and for the benefit of all interests involved in the maritime venture. So detailed has the "memorandum" become in some policies that the insurer's liability is limited with respect to considerably over 100 specific articles or classes of articles. Referring to the above clause, it will be noted that certain articles, that are very susceptible to damage, are "free from average unless general." Such articles, in other

words, are insured only against general average and total loss. As regards other articles, owing to their smaller susceptibility to damage, the underwriter assumes liability for particular average losses if amounting respectively to twenty per cent, seven per cent, or ten per cent.

In ascertaining whether the memorandum percentages (the so-called "franchise") have been reached, no consideration is given to general average; nor can extra charges for proving the claim or making the survey be included in the loss in order to reach the percentage. Regard is had only for particular average, and if the claim here equals or exceeds the percentage mentioned, the whole damage (not merely the excess) plus the extra charges must be borne by the underwriter. But all charges incurred for saving and preserving the property are recoverable, as has already been explained, under the sue, labor and travel clause. In voyage policies it is usual to make the insurer liable by combining successive losses, each of which may be less than the stipulated percentage. In time policies, however, only the losses of one round voyage are combined to determine the percentage. Very frequently deductible average clauses are employed, whereby all loss up to the percentage is deducted from the claim under all circumstances, and the underwriter is rendered liable only for the excess. Where cargoes or vessels are very valuable, it is also customary to sub-divide the risk as regards the application of the percentages. Thus a cargo may be divided into "series," each depending upon the nature of the subject-matter (as ten bales of cotton, ten chests of tea, etc.), and the underwriter made liable where the loss in respect to one of these series reaches the proper percentage. Likewise in the case of a vessel, separate values are often introduced for the hull, machinery, fittings, etc., with the understanding that the percentage rule should apply to each valuation separately.

Hull policies contain a variety of clauses which limit the underwriter's liability with respect to partial losses. Most frequently a minimum franchise of 3 or 5 per cent, or a definitely stipulated sum, is used and this minimum is applied "on each valuation separately or on the whole." The wording customarily used is as follows:

This policy is warranted free from particular average under 3 per cent, or unless amounting to (here follows some figure like \$2,000 or \$5,000), but nevertheless when the vessel shall have been stranded, sunk, on fire or in collision with any other vessel, underwriter shall pay the damage occasioned thereby, and the expense of sighting the bar after stranding shall be paid, if reasonably incurred even if no damage be found.

Average payable on each valuation separately or on the whole, without deduction of thirds, new for old, whether the average be particular or general.

Various reasons justify the use of the memorandum clause. One is the elimination of numerous irritating disputes with the policyholder. Owing to their inherent nature, certain commodities are much more susceptible to frequent small losses resulting from dampness, sweating, change of flavor, atmospheric conditions and other reasons. Such losses do not involve a legal liability on the part of the underwriter, yet will cause an endless amount of misunderstanding if not specifically defined in the contract. It is also desirable, as far as possible, to place all insurance upon cargo on approximately the same basis, i.e., to place the various classes of goods in proper relationship to one another. By using different percentages to indicate the extent of loss before liability attaches, the several groups of articles are counterbalanced in a measure so that the underwriter's liability for all kinds of goods is approximately equal, thus enabling him to charge a fairly uniform

premium. Memorandum limitations also serve to eliminate numerous small losses, which in the aggregate, however, would constitute a very large proportion, if not the major part, of the grand total of marine losses. There will also be an elimination of the heavy expense connected with the adjustment of innumerable small claims. If all such losses and their accompanying adjustment expenses were assumed by underwriters, the cost of marine insurance would probably be doubled, thus placing a needless burden upon commerce. Even if they were assumed by the underwriter, it is questionable whether the insured would be benefited financially because the cost of adjusting all such minor losses would probably exceed the losses themselves.

Subrogation Clauses.—Three such clauses are commonly found in cargo and hull policies. One is designed to prevent carriers from shirking their liability for negligence by placing a provision in their bills-of-lading to the effect that the shipper's insurance on cargo shall enure to the benefit of the carrier. Underwriters desire to pay losses, due to the negligence of the carrier, directly to the insured and then seek reimbursement by suing the carrier in the name of the insured. Carriers, however, have sought to nullify such action on the part of underwriters by agreeing with the shipper that any insurance carried by him shall enure to the benefit of the carrier. This practice led to the introduction of a policy stipulation to the effect "that the insurance shall not enure directly or indirectly to the benefit of the carrier, etc. by stipulation in bill of lading or otherwise and that any act or agreement by the assured, prior or subsequent hereto, whereby any carrier is given the benefit of any insurance affected thereon, shall render this policy of insurance null and void." The other two clauses prohibit the insured (1) from making any arrangement whereby the underwriter's right of recovering the loss from the

party at fault is released, impaired or lost; and (2) from assigning any interest or subrogating any right under the policy without the consent of the underwriter.

Important Hull Policy Provisions.—Mention should be made of three important clauses not found in cargo policies, but which are wellnigh universally employed in hull contracts. Briefly explained they are:

“The collision clause.”—Although the damage suffered by the insured vessel through collision is covered by a marine policy, court decisions have made necessary a separate agreement whereby the underwriter undertakes to assume liability for the damage caused to the other vessel. This agreement has taken the form of the so-called “collision” or “running down” clause, which constitutes approximately one-fifth of the entire hull policy. (For the wording of this clause see p. 369.)

According to the clause, the underwriter agrees (1) to pay any sum paid by the insured for damages, not exceeding in respect of any one collision the value of the ship insured, in the proportion that the insurance carried bears to the value of the insured vessel, and (2) to compensate the insured for a similar proportion of the costs incurred in case the liability of the vessel has been contested with the consent in writing of a majority (in amount) of the underwriters. Liability, however, does not extend to reimbursement for payment made with respect to the removal of obstructions under statutory powers, for injury to harbors, wharves, piers, etc., or for loss of life or personal injury. Such losses or expenses, as previously explained, are covered under protection and indemnity insurance. When both vessels are to blame, the clause provides that: “Unless the liability of the owners or charterers of one or both of such vessels become limited by law, claims under the collision clause shall be settled on the principle of *cross-liability* as if the owners or charterers of each vessel had

been compelled to pay the owners or charterers of the other of such vessels such one-half or other proportion of the loss damages as may have been properly allowed in ascertaining the balance or sum payable by or to the assured or charterers in consequence of such collision." The insertion of the principle of "cross-liabilities" in the collision clause has been comparatively recent. Its purpose is to meet court decisions which have adopted the plan of apportioning the blame on each vessel and then have one of the vessels pay any excess balance to the other, thus bringing about a payment by the underwriters to one vessel only.

The Disbursements Warranty.—Another clause occupying considerable space in hull policies is the so-called "disbursements warranty." (For the wording of this clause see p. 367.) Its purpose is to make the insured take out a sufficient amount of "full form insurance," which, as already explained, covers total as well as partial losses. Were it not for an agreement of this kind, the insured would be tempted to cover an excessive portion of the value of the vessel with "total loss only" insurance, owing to the lower rates charged for this type of coverage as compared with "full form policies."

"Inchmaree clause."—In the famous case of the steamer *Inchmaree*,⁴ the House of Lords ruled that an underwriter's liability did not extend to loss occasioned by the bursting of a vessel's boilers or the occurrence of accidents to its machinery. Such losses were not regarded as coming within the meaning of the "perils clause" of the policy. Following this ruling, a so-called "Inchmaree clause" was incorporated into hull policies, and is now used generally in contracts insuring mechanically propelled vessels. The wording of the clause is usually as follows:

⁴ *Thames and Mersey Marine Insurance Co., Ltd. vs. Hamilton, Fraser and Co.* (1887), VI. Asp. M. L. C., 200.

This insurance also specially to cover (subject to the free of average warranty) loss of, or damage to hull or machinery, through the negligence of master, charterers, mariners, engineers, or pilots, or through explosions, bursting of boilers, breakage of shafts, or through any latent defect in the machinery or hull, provided such loss or damage has not resulted from want of due diligence by the owners of the ship, or any of them, or by the managers. Masters, mates, engineers, pilots, or crew not to be considered as part owners within the meaning of this clause should they hold shares in the steamer.

SPECIMEN HULL POLICY

(The cargo policy has been reproduced section by section under the respective headings of the foregoing chapter, and for this reason will not be reprinted.)

American Hull Policy 1917 Form

..... Insurance Company No.....

BY THIS POLICY OF INSURANCE

..... *For account of*

Loss, if any, payable to *or order,*

Do make insurance and cause

To be insured lost or not lost, to the amount of *Dollars*

Amount

Insured,

\$.....

At and from the

Day of

19.....

Until the

Day of

19.....

(Beginning and ending with Greenwich Mean Time.)

But Warranted as follows:—

Upon the body, tackle, apparel, stores, ordnance, munitions, artillery, boats, and other furniture, boilers and machinery of the Steamship called the..... S.S. or by whatsoever name or names the said Vessel is or shall be named or called; beginning the adventure upon the said Vessel, &c., as above, and so shall continue and endure during the period aforesaid, as employment may offer, in port and at sea, in docks and graving docks, and on ways, gridrons and pontoons, at all times, in all places, and on all occasions, services and trades whatsoever and wheresoever, under steam or sail; with leave to sail with or without pilots, to tow and be towed, and to assist vessels and / or craft in all situations and to any extent,

and to go on trial trips. With liberty to discharge, exchange and take on board goods, specie, passengers, and stores, wherever the Vessel may call at or proceed to, and with liberty to carry goods, live cattle, &c., on deck or otherwise, but warranted free of any claim in respect of deck cargo. Including all risks of docking, undocking, changing docks, or moving in harbor and going on or off gridiron or graving docks as often as may be done during the currency of this Policy.

The said Ship, &c., for so much as concerns the Assured, by agreement between the Assured and Assurers in this Policy, are and shall be valued at as follows:

Hull, Tackle, apparel, furniture, &c	.....	\$	.....	Dollars,
Boilers, machinery, &c., and everything connected therewith	.....	\$	.....
Donkey boilers, winches, cranes, windlasses, steering gear, and electric light apparatus, shall be deemed to be part of the hull and not part of the machinery. Refrigerating machinery and insulation appertaining thereto not covered unless expressly included in this Policy, or unless the property of the owners of the Vessel.	.....	\$	.....
Premium	.....	\$	.....

\$.....
Rate.....%

THE INSURERS to be paid in consideration of this insurance..... Dollars,
being at the rate of per cent.

Warranted that the amount insured for account of the Assured and / or their managers on Disbursements, Commissions and / or similar interests "policy proof of interest" or "full interest admitted" or on excess or increased value of Hull or Machinery however described shall not, except as indicated below, exceed 15% of the insured valuation of the Vessel, but the assured may in addition thereto effect "policy proof of interest" or "full interest admitted" insurance on any of the following interests.

Premiums (reducing or not reducing monthly) to any amount actually at risk, and
Freight and / or Chartered Freight and / or Anticipated Freight and / or Earnings and / or Hire or Profits on Time Charter and / or Charter for series of voyages for any amount not exceeding in the aggregate 25% of the insured valuation of the Vessel; and if the actual amount at risk on any or all of such interests

shall exceed such 25% of the insured valuation of the Vessel, the Assured and / or their managers may, without prejudice to this warranty, insure whilst at risk the excess of such interests reducing as earned."

Provided always that a breach of this warranty shall not afford underwriters any defense to a claim by mortgagees or other third parties who may have accepted this policy without notice of such breach of warranty, nor shall it restrict the right of the Assured and / or their managers to insure in addition General Average and / or Salvage Disbursements whilst at risk.

TOUCHING THE ADVENTURES AND PERILS which we, the said Assurers, are contented to bear and take upon us, they are of the Seas, Men-of-War, Fire, Enemies, Pirates, Rovers, Thieves, Jetisons, Letters of Mart and Counter-Mart, Surprisals, Takings at Sea, Arrests, Restraints and Detainments of all Kings, Princes and Peoples, of what nation, condition or quality soever, Barratry of the Master and Mariners, Explosions, Riots, or other causes of whatsoever nature arising either on shore or otherwise, causing Loss of or injury to the Property hereby insured, and of all other Perils, Losses, and Misfortunes that have or shall come to the Hurt, Detriment, or Damage of the said Ship, &c., or any part thereof. And in case of any Loss or Misfortune, it shall be lawful for the Assured, their Factors, Servants, and Assigns, to sue, labor, and travel for, in, and about the Defence, Safeguard, and Recovery of the said Ship, &c., or any part thereof, without prejudice to this Insurance to the Charges whereof the Assurers will contribute according to the Rate and Quantity of the sum herein assured. And it is expressly declared and agreed that no act of the Insurer or Insured in recovering, saving or preserving the property insured shall be considered as a waiver or acceptance of abandonment.

THIS INSURANCE ALSO SPECIALLY TO COVER (SUBJECT TO THE FREE OF AVERAGE WARRANTY) LOSS OF, OR DAMAGE TO HULL OR MACHINERY, THROUGH THE NEGLIGENCE of Master, Charterers, Mariners, Engineers, or Pilots, or through explosions, bursting of boilers, breakage of shafts, or through any latent defect in the machinery or hull, provided such loss or damage has not resulted from want of due diligence by the owners of the Ship, or any of them, or by the Manager, Masters, Mates, Engineers, Pilots, or Crew not to be considered as part owners within the meaning of this clause should they hold shares in the steamer.

And it is further agreed, that IF THE SHIP HEREBY INSURED SHALL COME INTO COLLISION WITH any other Ship or Vessel, and the Assured or Charterers shall in consequence thereof become liable to pay, and shall pay by way of damages to any other person or persons any sum or sums not exceeding in respect of any one such collision the value of the Ship hereby insured, we, the Assurers, will pay the Assured or Charterers such proportion of such sum or sums so paid as our subscriptions hereto bear to the value of the Ship hereby Insured. And in cases where the liability of the Ship has been contested with the consent in writing of a majority of the Underwriters on the hull and / or machinery (in amount) we will also pay a like proportion of the costs thereby incurred or paid; but when both Vessels are to blame, then, unless the liability of the Owners or Charterers of one or both of such Vessels becomes limited by law, claims under the Collision Clause shall be settled on the principle of CROSS-LIABILITIES as if the Owners or Charterers of each Vessel had been compelled to pay to the Owners or Charterers of the other of such Vessels such one-half or other proportion of the latter's damages as may have been properly allowed in ascertaining the balance or sum payable by or to the Assured or Charterers in consequence of such collision; and it is further agreed that the principles involved in this clause shall apply to the case where both Vessels are the property, in part or in whole, of the same Owners or Charterers, all questions of responsibility and amount of liability as between the two Ships being left to the decision of a single Arbitrator, if the parties can agree upon a single Arbitrator, or failing such agreement, to the decision of Arbitrators, one to be appointed by the Managing Owners or Charterers of both Vessels, and one to be appointed by the majority (in amount) of Underwriters interested in each Vessel; the two Arbitrators chosen to choose a third Arbitrator before entering upon the reference, and the decision of such single, or of any two of such three Arbitrators, appointed as above, to be final and binding. PROVIDED ALWAYS that this clause shall in no case extend to any sum which the Assured or Charterers may become liable to pay, or shall pay for removal of obstructions under statutory powers, for injury to harbors, wharves, piers, stages, and similar structures, consequent or such collision, or in respect of the cargo or engagements of the Insured Vessel, or for loss of life, or personal injury. And provided also that in the event of any claim being made by Charterers under this clause they shall not be entitled to recover in respect of any liability to which the

owners of the Ship, if interested in this Policy at the time of the Collision in question, would not be subject nor to a greater extent than the Shipowners would be entitled in such event to recover.

And it is further agreed that in the event of salvage, towage, or other assistance being rendered to the Vessel hereby insured by any Vessel belonging in part or in whole to the same Owners or Charterers, the value of such services (without regard to the common ownership of the Vessels) shall be ascertained by arbitration in the manner above provided for under the Collision Clause, and the amount so awarded so far as applicable to the interest hereby insured shall constitute a charge under this Policy.

GENERAL AVERAGE AND SALVAGE CHARGES PAYABLE in accordance with York-Antwerp Rules, 1890, if so provided for in the contract of affreightment. As regards matters not provided for in the York-Antwerp Rules, 1890 (when the contract of affreightment provides for such rules), and also when the contract of affreightment does not provide for such rules, General Average and salvage charges shall be payable in accordance with the laws and usages of the United States. Provided always that when an adjustment according to the laws and usages of the port of destination is properly demanded by the owners of the cargo, General Average shall be paid in accordance with same.

No claim shall be allowed in respect of scraping or painting the Vessel's bottom except as provided in Rule of Practice VIII of the Association of Average Adjusters of the United States.

Grounding in the Panama Canal or in the Suez Canal or in the Manchester Ship Canal or its connections, or in the River Mersey above Rock Ferry Slip, or in the River Platte (above Buenos Aires) or its tributaries, or in the Danube, Demerara, or Bilbao River, or on the Yenikale or Bilboa Bar, shall not be deemed to be a stranding.

AVERAGE PAYABLE ON EACH VALUATION separately or on the whole, without deduction of thirds, new for old, whether the average be particular or general.

In no case shall Underwriters be liable for unrepaired damage in addition to a subsequent total loss sustained during the term covered by this Policy.

IN ASCERTAINING WHETHER THE VESSEL IS A CONSTRUCTIVE TOTAL LOSS the insured value shall be

taken as the repaired value, and nothing in respect of the damaged or break-up value of the Vessel or wreck shall be taken into account.

In the event of total or constructive total loss, no claim to be made by the Underwriters for freight, whether notice of abandonment has been given or not.

NOTWITHSTANDING ANYTHING HEREIN CONTAINED TO THE CONTRARY THIS POLICY IS WARRANTED FREE FROM PARTICULAR AVERAGE UNDER 3 PER CENT, OR UNLESS AMOUNTING TO \$4,850, but nevertheless when the Vessel shall have been stranded, sunk, on fire, or in collision with any other Ship or Vessel, Underwriters shall pay the damage occasioned thereby, and the expense of sighting the bottom after stranding shall be paid, if reasonably incurred, even if no damage be found.

THE WARRANTY AND CONDITIONS AS TO AVERAGE UNDER 3 PER CENT TO BE APPLICABLE TO EACH VOYAGE as if separately insured, and a voyage shall be deemed to commence at one of the following periods to be selected by the Assured when making up the claim, viz.: at any time at which the Vessel (1) begins to load cargo or (2) sails in ballast to a loading port. Such voyage shall be deemed to continue during the ensuing period until either she has made one outward and one homeward passage (including an intermediate ballast passage, if made) or has carried and discharged two cargoes, whichever may first happen, and further, in either case, until she begins to load a subsequent cargo or sails in ballast for a loading port. When the Vessel sails in ballast to effect damage repair such sailing shall not be deemed to be a sailing for a loading port although she loads at the repairing port. In calculating the 3 per cent above referred to, particular average occurring outside the period covered by this Policy may be added to particular average occurring within such period provided it occur up on the same voyage (as above defined), but only that portion of the claim arising within such period shall be recoverable hereon. The commencement of a voyage shall not be so fixed as to overlap another voyage on which a claim is made on this or the preceding Policy.

SHOULD THE VESSEL AT THE EXPIRATION OF THIS POLICY BE AT SEA, or in distress, or at a port of refuge or of call, she shall, provided previous notice be given to the Underwriters, be held covered at a pro rata monthly premium to her port of destination.

SHOULD THE VESSEL BE SOLD OR TRANSFERRED TO OTHER OWNERSHIP, then, unless the Underwriters agree in writing to such sale or transfer, this Policy shall thereupon become canceled from date of sale or transfer, unless the Vessel has cargo on board and has already sailed from her loading port, or is at sea in ballast, in either of which cases such cancellation shall be suspended until arrival at final port of discharge if with cargo, or at port of destination if in ballast. A pro rata daily return of premium shall be made.

NOTWITHSTANDING ANYTHING HEREIN CONTAINED TO THE CONTRARY, this Policy is warranted free of capture, seizure, arrest, restraint, or detainment, and the consequences thereof, or of any attempt thereat (piracy excepted) and also from all consequences of hostilities or warlike operations, whether before or after declaration of war.

To Return	{	per cent net for each uncommenced month if it be mutually	}	and arrival
		agreed to cancel this Policy.		
		per cent net for each consecutive		days the Vessel may
		be laid up in port:—		

A period in port falling between two insurances to be allowed pro rata on each, underwriters on each insurance agreeing to pay their pro rata proportion of the Return due.

IN THE EVENT OF ACCIDENT whereby loss or damage may result in a claim under this Policy, NOTICE SHALL BE GIVEN TO THE UNDERWRITERS, where practicable, prior to survey, so that they may APPOINT THEIR OWN SURVEYOR IF THEY SO DESIRE; and whenever the extent of the damage is ascertainable, the majority (in amount) of the Underwriters may take or may require the Assured to take tenders for the repair of such damage. In cases where a tender is accepted by or with the approval of Underwriters, the Underwriters will make an allowance at the rate of 30 per cent per annum on the insured value for the time actually lost in waiting for tenders. IN THE EVENT OF THE ASSURED FAILING TO COMPLY WITH THE CONDITIONS OF THIS CLAUSE 15 PER CENT SHALL BE DEDUCTED FROM THE AMOUNT OF THE ASCERTAINED CLAIM.

HELD COVERED in case of any breach of warranty as to cargo, trade, locality, or date of sailing, provided notice be given, and any additional premium required be agreed immediately after receipt of advices of breach or proposed breach by Owners.

1. Where the Assured has paid, or is liable for, any General Average contribution and the contributory value is greater than the insured value, the amount recoverable under this Policy shall be only in the proportion that the amount insured hereunder bears to the contributory value and where the contributory value has been reduced by a Particular Average for which these Assurers are liable, the amount of Particular Average Claim under this Policy shall be deducted from the amount insured under this Policy in order to ascertain what share of the contribution is recoverable from these Assurers; the extent of the liability of these Assurers for salvage shall be computed on the same principle.

2. In event of non-payment of premium thirty days after attachment this Policy may be canceled by the Assurers upon five days' written notice being given the assured.

3. No recovery for a Constructive Total Loss shall be had hereunder, unless the expense of recovering and repairing the vessel shall exceed the insured value.

In Witness Whereof, the said.....INSURANCE COMPANY has caused this Policy to be signed by its President at....., but it shall not be valid until countersigned by....., Managers.

Countersigned the.....day of.....19.....*President.*

.....*Managers.*

CHAPTER XXIV

MARINE PERILS AGAINST WHICH PROTECTION IS GRANTED

Types of Losses Not Assumed under Marine Policies.

—Marine insurance is not intended to indemnify all kinds of losses. Its purpose is not to protect against losses which are occasioned by gross negligence or fraud, or which are the inevitable result of customary wear and tear by the ordinary forces of nature, or of natural deterioration in quality or diminution in quantity through decay, leakage, or evaporation in the course of time. Instead, marine insurance has for its purpose protection against fortuitous losses, i.e., those which are accidental in character and beyond the control of the insured. Customary and inevitable loss, connected with the inherent nature of goods, or their packing, should be borne by business as a normal item in the cost of operation, and should not serve to increase abnormally the size of insurance premiums. Moreover, losses attributable to the negligence of the custodian of property (the carrier for example) are not regarded by most authorities as a fit subject for protection under marine insurance contracts, although competition has been responsible for their assumption, as in the case of loss of cargo through pilferage.

The "Perils Clause" of the Policy.—

Touching the adventures and perils which the said. . . Insurance Company is contented to bear, and takes upon itself in this voyage, they are of the seas, men-of-war, fires,

enemies, pirates, rovers, thieves, jettisons, letters of mart and countermart, reprisals, takings at sea, arrests, restraint and detainments of all kings, princes, or people, of what nation, condition or quality soever, barratry of the master and mariners and all other perils, losses and misfortunes that have or shall come to the hurt, detriment or damage of the said goods and merchandises, or any part thereof.

This is probably the quaintest and most interesting portion of modern marine insurance policies. Underwriters have been extremely reluctant to have the wording of this clause modernized, and thus run the danger of introducing uncertainty in a basic section of the contract, every word of which has been interpreted by the courts and the meaning of which is universally understood. Although mentioned without any apparent attempt at logical arrangement, the many perils enumerated by the clause would seem to lend themselves to a four-fold classification, namely, (1) the "perils of nature," such as "perils of the sea" and fire; (2) those attributable to the conduct of those aboard the vessel, like jettison and barratry; (3) perils arising out of the conduct of those not aboard the vessel, such as the perils of war; and (4) "all other perils, losses, and misfortunes," to quote the so-called terminal clause, "that have or shall come to the hurt, detriment, or damage of the vessel or cargo." Some of the enumerated perils are self-explanatory and require little comment. Others, though very important at one time, when travel was slow and dangerous and commerce subject to piracy and privateering, have become relatively unimportant.

"Perils of the Sea."—Emphasis should be placed on the expression "*of the sea*" in order to distinguish this type of perils from those occurring "*on*" the sea. In other words, the perils of the sea do not comprehend all kinds of losses occurring in the course of navigation. According to Phillips, perils of the sea "comprehend those of the

winds, waves, lightning, rocks, shoals, collision, and, in general, all causes of loss and damage to the property insured, arising from the elements and inevitable accidents." Among the most important hazards falling under this head are excessive action of the winds and waves, lightning, stranding, sinking, collision between vessels, collision due to ice, fog, darkness or obstructions, and damage by salt water, tidal waves or stress of weather.

Fires.—The fire hazard, mentioned separately as a peril "on" the sea and not "of" the sea, has always been a serious one with respect to marine risks. As in fire insurance, so also in marine insurance, underwriters are not only liable for the actual destruction of vessel or cargo by fire, but also assume all consequential loss resulting from heat, smoke and odor, or from water, steam, or chemical gases used to quench the fire. Owing to the seriousness of the hazard from the standpoint of both life and property, fire prevention on vessels has been receiving serious attention in the form of the installation of steam injectors, fireproof and water-tight bulkheads, and automatic alarm and sprinkler services.

Pirates, Rovers and Thieves.—The first two terms are difficult to distinguish, yet they both refer "to the acts of outlaws committing depredations on the high seas in violation of international law." Paragraph 8 of the Rules of Construction for the British Marine Insurance Act of 1906 defines "pirates" as "including passengers who mutiny and rioters who attack the ship from the shore." The term thieves, on the other hand, has been defined by paragraph 9 of the same Rules as "not covering clandestine theft committed by any one of the ship's company, whether crew or passengers." Instead, it refers to "robbery by force and must be distinguished from theft or pilferage by stevedores, members of the crew and others who through stealth take merchandise or ships' supplies." The latter

risk, as explained elsewhere,¹ is not considered by leading authorities to come properly within the scope of a marine insurance contract on the ground that it is considered bad policy to relieve the carrier from liability for such losses. Various state courts, however, have held the term "thieves" to include pilferage, and accordingly it is common for underwriters who desire to exclude this risk, to make the matter clear by inserting in the policy the words "assailing thieves." But competition has caused many underwriters to acquiesce in the acceptance of liability for losses by pilferage, this usually being done by inserting a special stipulation to that effect. There is, however, a general agreement that the practice is unfortunate. Not only is pilferage a type of loss the payment for which should be an obligation upon the carrier, but it is extremely difficult to prove that the property was lost while in possession of the carrier. Pure negligence is the cause of much of the loss through pilferage; and carriers, knowing that shippers can secure insurance protection, have shown a much greater indisposition to settle claims.

Jettison.—As will be explained later, this peril is very closely identified with the subject of "general average loss" and has been defined as "the throwing overboard of a part of the cargo or any article on board the ship, or the cutting and casting away of masts, spars, rigging, sails or other furniture for the purpose of lightening or relieving the ship in case of emergency."²

The act of jettison must be voluntary, and must have for its purpose the preservation of the entire venture. The term, therefore, does not contemplate the throwing overboard (1) of goods because of natural deterioration

¹ S. S. Huebner: "Marine Insurance," p. 58-59.

² Willard Phillips: "A Treatise on the Law of Insurance," i. 635.

or inherent defect or (2) of deck cargo, except where expressly permitted by custom or the terms of the policy. "Washing overboard," likewise, has been regarded as a peril of the sea and not as constituting a voluntary act. When jettison is accompanied by loss to other property through water damage, it is important to note that the underwriter is liable for this loss also, as well as the loss of the property actually jettisoned.

Barratry.—Arnould defines this peril as comprising not only "every species of fraud and knavery covinously committed by master or mariners with the intention of benefiting themselves at the expense of their owners, but every willful act on their part of known illegality, gross malversation, or criminal negligence by whatever motive induced, whereby the owners or the charterers of the ship are, in fact, damnified."³ Among leading illustrations of barratrous acts there may be mentioned the scuttling of a ship, unlawfully destroying or injuring a vessel, unlawful misconduct or breach of duty on the part of master or mariners by running it ashore, setting it on fire, or abandoning it, sailing a vessel or diverting it from the true course of travel with the object of obtaining gain in some way, and embezzlement of cargo.

Perils of War.—This group comprises approximately half of all the perils enumerated in the "perils clause," namely, men-of-war, enemies, letters of mart and counter-mart, reprisals, takings at sea, arrests, and restraints and detainments.

"Men-of-war" refers not merely to every type of fighting craft, but also to aeroplanes, torpedoes, stationary or floating mines, depth bombs, and any of the modern devices for carrying on naval warfare. Should there be any exceptions it is clear that they would be covered

³ Joseph Arnould: "The Law of Marine Insurance," ii. 952.

by the next expression, namely, "enemies." Some writers also maintain that this term covers "against the acts of privateers, and others authorized to conduct warfare under a belligerent flag without, however, belonging to the country of that flag."

Most writers maintain that it is impossible to distinguish between "letters of mart and countermart" and "reprisals." The first phrase relates to letters granted by belligerent governments to their citizens authorizing them to retaliate on the enemy in order to recompense themselves for losses suffered through enemy acts. Reprisals, as already stated, are viewed by most writers as conveying the same thought. Some have, however, suggested that the term might have been intended to refer "to acts of retaliation against crimes committed by one of the belligerents in violation of international law."⁴ It should also be noted that Lloyd's policy uses the word "surprisals" instead of "reprisals."

The two terms "takings at sea" and "arrests" are also difficult to distinguish. The first expression refers to "the capture of vessel and cargo with a view to retaining possession." With the possible exception of sinking by submarines, this particular hazard probably proved the most serious of all the war perils during the recent war. The expression "arrests" is regarded as referring "to capture with a view to having an examination of the property before freeing or condemning the same."

"Restraint" has reference "to any restriction, such as an embargo, which prevents vessels from using the ports of the country imposing the measure, thus causing loss through interruption in regular trade, and possibly

⁴W. D. Winter: "Marine Insurance: Its Principles and Practice," p. 151.

the sacrifice of cargo." "Detainment" refers to the act of detaining a vessel and cargo by blockade, quarantine, or other governmental regulation, but does not comprehend losses resulting from ordinary delay, defective machinery, changing market conditions, and the like. The qualifying phrase, "of all kings, princes or people of what nation, condition, or quality soever," also conveys the idea that the restraint or detainment must not be the result of the acts of individuals as distinguished from governmental groups. Paragraph 10 of the Rules for Construction of the British Marine Insurance Act of 1906 states that the term "arrests, etc., of kings, princes, and people refers to political or executive acts, and does not include a loss caused by riot or by ordinary judicial process." The expression "of what nation, condition or quality soever" would seem to make it clear that the acts referred to may be those of a government that is not duly constituted or recognized by other nations.

"All Other Perils, Losses and Misfortunes."—The closing portion of the perils clause—"all other perils, losses, and misfortunes that have or shall come to the hurt, detriment or damage of the said goods or merchandise, or any part thereof"—would seem to make the underwriter liable for losses arising from all causes not specifically mentioned in the policy. The courts, however, have not given this so-called "terminal expression" the all-comprehensive meaning that might be inferred from the wording. Instead, the real intent of the clause, according to legal decisions, is to limit the underwriter's liability to losses resulting from causes similar to those enumerated in the perils clause, i.e., losses due only to accidental causes connected with the sea or the action of the elements. Losses due to inherent defects of the subject-matter insured or to natural causes are, therefore, not regarded as coming under the meaning of the

clause. The British Marine Insurance Act of 1906 also defines this portion of the perils clause as "including only perils similar in kind to the perils specifically mentioned in the policy."

Additional Risks Assumed by Endorsement.—*Explosion, damage to machinery, and latent defects.*—As previously noted, the so-called Inchmaree clause⁵ serves to extend the policy's coverage to certain types of losses which the courts do not regard as coming within the meaning of "all other perils, losses and misfortunes." Reference is had to (1) loss of or damage to hull or machinery through the negligence of master, charterer, mariners, engineers or pilots, (2) explosions, bursting of boilers and breakage of shafts, and (3) latent defects in the machinery and hull. But in assuming all of these risks, it is expressly declared that the "loss or damage must not have resulted from want of due diligence by the owners of the ship or any of them, or by the managers."

*Theft, pilferage, non-delivery and breakage.*⁶—Within recent years, losses of this character have reached enormous proportions in American commerce. In March, 1921, eight New York underwriting offices combined their figures covering theft, pilferage and non-delivery losses, and the aggregate annual loss was approximately \$4,800,000. This figure, however, by no means represents the total loss, since there must be added the losses (1) of all the rest of the underwriting market, (2) those on imports into this country insured in the countries of origin, and (3) those on exports from this country in-

⁵ See pages 364 and 365.

⁶ For a detailed discussion of this subject, see S. S. Huebner: "Theft and Pilferage in the United States Export and Import Trade," Bulletin of the Pan-American Union, March, 1922. Also see Hearings on "Theft, Pilferage, Non-delivery, and Breakage of Export and Import Shipments" before the Sub-committee on Marine Insurance of the Committee on the Merchant Marine and Fisheries, House of Representatives, July 18-20, 1921.

sured in the countries of destination. Such heavy losses are naturally reflected in insurance rates. Prior to the recent war, only nominal theft and pilferage charges were made in connection with merchandise shipments, the rates to South American ports, for example, ranging from one-fourth of one per cent to one per cent. By July, 1921, the rate varied from three-eighths of one per cent to the United Kingdom, one to one and one-half per cent to Spain, four to five per cent to Portugal, three to five per cent to Italy, and five to fifteen per cent to Mexico and South America, depending on the ports under consideration.

The theft and pilferage problem is strategically associated with the development of our foreign trade opportunities, and competition was largely responsible for the assumption of that type of risk by underwriters. Owing to heavy losses, however, many American companies found it necessary by the middle of 1921, despite the very high rates, to withdraw altogether from this field of insurance. Underwriters, generally, have protested strongly against existing conditions, contending that the risk of theft, pilferage and non-delivery is transferred entirely to them, despite the fact that they do not have the cargo within their custody and are thus not in position to exercise any supervisory control. Even when accepting the theft and non-delivery hazard, practically all leading underwriters follow the plan, with respect to the hazardous routes, of agreeing to pay not more than 75 per cent of any such claim, the merchant being obliged to be a coinsurer for the balance. Merchants are thus placed in a very difficult position, especially since many, if not most, of the carriers assume only a nominal liability under their bills-of-lading, and often expressly exempt themselves from all liability for theft and pilferage losses.

CHAPTER XXV

TYPES OF MARINE LOSSES

Classification of Marine Losses.¹—From an insurance standpoint, marine losses are either “total” or “partial.” Total losses may further be classified into those which are “actual” and those which are “constructive.” Partial losses, in turn, are of three kinds, namely, “general average losses,” “particular average losses,” and “salvage.” The several expressions referred to appear repeatedly in marine insurance policies, and a knowledge of their meaning is essential to a proper understanding of the basis upon which marine insurance is written.

“Actual” and “Constructive” Total Loss.—The British Marine Insurance Act of 1906 defines actual total loss as comprising all cases “where the subject-matter is destroyed or so damaged, as to cease to be a thing of the kind insured, or when the insured is irretrievably deprived thereof.” According to the same Act, a constructive total loss exists:

“Where the subject-matter insured is reasonably abandoned on account of its actual total loss appearing to be unavoidable, or because it could not be preserved from actual total loss without an expenditure which would exceed its value when the expenditure has been incurred. In particular, there is a constructive total loss:

¹ For a detailed discussion of marine losses, see S. S. Huebner: “Marine Insurance,” Chapters VII, VIII, and IX, dealing respectively with “Total Loss,” “General Average,” and “Particular Average.”

(1) Where the assured is deprived of the possession of his ship or goods by a peril insured against, and (a) it is unlikely that he will recover his ship or goods, as the case may be, or (b) the cost of recovering the ship or goods, as the case may be, would exceed their value when recovered; or

(2) In the case of damage to a ship where she is so damaged by a peril insured against that the cost of repairing the damage would exceed the value of the ship when repaired; or

(3) In the case of damage to goods where the cost of repairing the damage and forwarding the goods to their destination would exceed their value on arrival."

Among leading illustrations of actual total loss there may be mentioned the sinking of a vessel or cargo beyond recovery, disappearance of vessel or cargo, or the destruction of vessel or cargo by fire or the indirect effects of fire. Constructive total loss, on the contrary, comprises those cases where a vessel has stranded, run ashore, or settled in shallow water, and where, although actual injury to the vessel may be slight, the cost of releasing and re-conditioning the same would be so great, as compared with its value afterwards, as to make the attempt financially inadvisable. Similarly, a vessel may be so damaged by fire or collision as to make the cost of salvage and repairs exceed the repaired value. A cargo may be damaged only partially, yet the circumstances surrounding the loss may be such as to make the remaining value, after deducting the costs of re-conditioning and conveyance to destination, less than the expenses actually incurred.

With respect to vessels the expenditures allowed, in ascertaining whether there is a case of constructive total loss, cover temporary repairs at a port of refuge, the salvage necessary to bring the vessel to a place of final

repair, and the permanent repairs at the port of destination. In the case of cargo, the expenditures allowed cover the cost of re-conditioning as well as the outlay necessary to forward the goods to destination. But it is important to note in this respect a vital distinction between the American and English practice. In England no claim for total loss can be made unless the cost of restoration is equal to 100 per cent or more of the value when repaired. The American rule, on the contrary, permits a vessel to be construed as a total loss when the cost of salvage and repair amounts to more than 50 per cent of the repaired value. Manifestly, the American rule is most advantageous to the insured. Yet the greater fairness of the English practice is generally recognized, and has been responsible for its general adoption by agreement in American hull policies. ✓

Abandonment.—Any consideration of constructive total loss necessarily involves a discussion of "abandonment." Should the insured decide to abandon the risk as a constructive total loss, he must give the underwriter a so-called "notice of abandonment." According to the British Marine Insurance Act the effect of abandonment is to entitle the underwriter "to take over the interest of the insured, in whatever may remain of the subject matter insured, and all proprietary rights incidental thereto." Such a practice, it should be observed, is totally at variance with that prevailing in fire insurance, where the standard fire policy expressly states that "there can be no abandonment." The British Marine Insurance Act furthermore provides that the notice of abandonment "may be given in writing or by word of mouth, or partly in writing and partly by word of mouth, and may be given in any terms which indicate the intention of the insured to abandon his insured interest in the subject matter insured unconditionally to the insurer."

It is only reasonable that the insured should give his notice of abandonment with reasonable dispatch following his receipt of reliable information concerning the loss. All known facts surrounding the loss should also be given to the underwriter. Unreasonable delay in giving the notice, or concealment of essential facts, may deprive the underwriter of the opportunity of acting promptly and effectively in the interest of saving the endangered or damaged property from further loss. It should also be noted that the underwriter is under no obligation to accept the notice of abandonment when it is tendered to him. Upon a refusal of acceptance, the insured should protect the property to the best of his ability as per the terms of the "sue, labor and travel clause," until such time as the constructive total loss character of the risk becomes a matter beyond dispute. Until actually accepted, the insured is free to withdraw the notice of abandonment. Or the insured and insurer may agree to defer the question of abandonment, and leave the matter to be determined by future developments, without prejudice to the rights of either party. But when once accepted the abandonment becomes irrevocable by either party, irrespective of subsequent changes in the condition of the property. Moreover, in the event of acceptance, the underwriter's obligation extends merely to the payment of the loss. He cannot be compelled to assume the obligations attaching to ownership, a matter of importance at times when ownership carries with it legal liability for liens of one kind or another so great as to make the property worse than valueless.

Definition and Purpose of General Average.—General average may be defined as covering losses and expenditures which result from the sacrifice of any interest voluntarily made by the master of a vessel, or other duly constituted authority, in time of real distress, for the

common safety of vessel, cargo, and freight, and which must be repaid proportionately by all the parties benefited. Justice demands, for example, that if a vessel owner cuts away masts and sails or voluntarily strands his vessel, or incurs expenses by putting into a port of refuge for the sake of preserving the cargo, he should not be obliged to bear the loss alone. Likewise, if a portion of the cargo is sacrificed in quenching a fire aboard the vessel, or is jettisoned to save the venture, it would be grossly unjust to make the owner of the sacrificed goods stand all the loss. Hence, the introduction of the principle that all such sacrifices should be compensated for by making them a charge upon the value of all the other interests involved.² According to

² Before a loss or expenditure can be allowed as coming under general average, it must meet every element of the definition. The following represent some of the leading types of general average losses and expenditures as allowed by the courts:

Jettison of deck cargo where usage permits the commodity to be carried on deck.

Consequential losses, such as water damage, arising from jettison if the same is a general average act.

Water or steam damage to cargo incurred through efforts to extinguish a fire.

Damage to machinery, sails or other portions of the vessel as a result of efforts to release a stranded vessel for the common benefit.

Voluntary running of a vessel ashore for the common benefit.

Running short of fuel, when the vessel was properly supplied with fuel for the voyage under contemplation, and thus being compelled to sacrifice a portion of the vessel's stores as fuel, and to incur other expenditures to reach a port of refuge.

Usual expenditures in putting into and in necessarily remaining in a port of refuge, such as wages and maintenance of crew, pilotage, harbor demands and port charges, expenses involved in the discharge of cargo in order to make necessary repairs, costs of warehousing and reloading the discharged cargo, and expenses connected with the departure from the port after repairs have been effected.

Cost of discharging cargo and supplies into lighters and of reshipping the same when seeking to release a vessel which has run ashore or has been stranded.

Payments made by the master for aid when beneficial to both vessel and cargo; also outlay necessary to acquire funds with which to pay general average expenditures.

Richards: "The rule of general average has its basis in the community of interest existing between the owners of ship and cargo, by reason of which losses intentionally incurred for the common safety ought to be equitably apportioned among the interests thereby benefited."³

Procedure in Adjusting General Average Losses.—In the event of a general average loss, the shipmaster must see to it, when the vessel arrives at destination, that all the different interests to be assessed shall give proper security for the payments they are likely to be called upon to make. Such security may take one of three forms, viz. (1) a general average bond whereby the signers agree to pay the assessment levied, or (2) a cash deposit equal to the estimated assessment, or (3) the underwriter's guarantee where the contributing interest is insured in a good company. All matters pertaining to the adjustment are usually in charge of a so-called general average adjuster, appointed by the owner of the vessel. Following the giving of proper security by the respective interests this adjuster must undertake the valuation of all the interests involved, since the general average loss must be contributed by all the interests in the venture in proportion to their respective values. Generally speaking, the law and usage of the port of destination applies, or the law and usage of the port of refuge if it becomes necessary to break up the voyage. The vessel will contribute on the value it possesses at the port of arrival, minus any outlay for repairs made following the general average act, but before it reaches the port where the voyage ends. The cargo contributes upon its "gross wholesale value at the port of destination in its then condition" after deducting all charges which must be paid upon arrival, and before the goods can be

³George Richards: "A Treatise on the Law of Insurance," p. 260.

marketed; while the freight contributes in proportion to the amount stated on the bill-of-lading.

Having determined the value of all the contributing interests, the adjuster must next ascertain the amount of loss or damage that any of the interests in the venture may have sustained. This involves an examination of all expenses incurred as well as a survey of the damaged goods. Care must here be exercised to separate the general average loss from that which may be due to other causes, as for example, loss due to water damage in extinguishing a fire as contrasted with the loss due to actual destruction by the fire itself. The difficulties encountered may be imagined in the case of a vessel carrying cargo owned by several hundred different parties and where the general average loss attaches to a large number of these interests. Under such circumstances the adjustment often takes months to complete and requires hundreds of pages for a statement of the facts.

When all the contributing values and all the losses have been determined, the adjuster must next ascertain the amount to be paid by each interest. Here it is important to bear in mind that the sacrificed interest must contribute its proportionate share, otherwise the owner of the sacrificed property would stand in a favored position as compared with the other interests, since he would recover his property in full while the other owners would be asked to make contributions and would be losers to that extent. Thus assuming that the vessel, cargo, and freight are valued respectively for general average purposes at \$500,000, \$300,000, and \$100,000, that there are three cargo owners, "A," "B," and "C," each owning \$100,000, and that \$20,000 of "C's" cargo has been jettisoned for the common benefit, the following apportionment of the general average loss would be made:

Total value (\$900,000) contributes total loss, or.....	<u>\$20,000.00</u>
Property saved (\$880,000) contributes 88/90 of \$20,000 or.....	\$19,555.55
Property jettisoned (\$20,000) contributes 2/90 of \$20,000 or.....	444.45
Total.....	<u>\$20,000.00</u>
Vessel valued at (\$500,000) contributes 50/90 of \$20,000 or.....	\$11,111.11
Cargo valued at (\$300,000) contributes 30/90 of \$20,000 or.....	6,666.66
Freight valued at (\$100,000) contributes 10/90 of \$20,000 or.....	2,222.22
Total.....	<u>\$20,000.00</u>

Of the total contribution of \$6,666.66 by the cargo, each of the cargo owners, including "C" who represents the sacrificed interest, will contribute a proportionate share. Since each of them owns a third interest in the cargo, each will contribute one-third of \$6,666.66, or \$2,222.22.

General Average Legally Independent of Marine Insurance.—Should a contributing interest be fully insured under a policy assuming general average losses, the underwriter becomes responsible for the payment of the general average contribution attaching to the insured interest. But should the interest be uninsured, it is important to note that the owner must pay the contribution himself, since general average is a legal liability entirely distinct from the subject of insurance. Moreover, when the contributing interests are insured, it is usually agreed that the underwriter pays general average contributions only in the proportion that the insured value bears to the contributing value.* If the sacrificed property is

*This is the English rule. In the United States, the Federal courts, as well as the court of New York, have held that the policy

insured, the underwriter becomes liable for the insured value, and upon payment of the same becomes subrogated to the right to receive reimbursement (for all except the contribution assessed against the sacrificed interest) from the contributions of the other interests.

Definition and Nature of Particular Average.—A particular average loss is defined by the British Marine Insurance Act as “a partial loss of the subject-matter insured, caused by a peril insured against, and which is not a general average loss.” As contrasted with general average, particular average losses do not represent a sacrifice for the common benefit of all the interests involved in the maritime venture. Accordingly, none of the other interests need contribute toward the re-payment of the lost property. In particular average the loss is accidental and, therefore, falls exclusively upon the owner of the lost or damaged property, or, if insured, upon his underwriter. Among leading illustrations of losses constituting particular average there may be mentioned the destruction of or damage to goods by fire, sea water, or accident during the process of unloading, and damage to vessel through straining, stranding, collision or fire. ✓

With respect to both the number of claims and the proportion of aggregate financial loss suffered through marine perils, particular average losses probably exceed in importance all of the other types of marine losses combined. The principles and problems connected with the adjustment of this type of loss vary materially according to the subject-matter of insurance, i.e., whether hull,

valuation is conclusive and that the underwriter is liable for all of the general average assessment, despite the fact that the insured value is less than the value upon which the general average assessment was based. The English rule is clearly the more equitable, and for this reason is frequently incorporated in American contracts by express agreement between the parties.

cargo, freight, profits or commissions. Such adjustments also involve the application of many technical rules which are of primary interest to expert average adjusters and which it is not the purpose of this volume to discuss.

Where a vessel is damaged by a marine peril covered by the policy, the insured is entitled to the "reasonable cost of the repairs, less customary deductions, but not exceeding the sum insured in respect to any one casualty." If the vessel remains unrepaired and also unsold in the damaged state, the indemnification should equal "the reasonable depreciation arising from the unrepaired damage, but not exceeding the reasonable cost of repairing such damage." Again, if the vessel is only partially repaired, the indemnification should equal "the reasonable cost of such repairs" plus "the reasonable depreciation arising from the unrepaired damage," the total, however, "not exceeding the cost of repairing the whole damage."⁵ Since particular average losses are usually paid by underwriters in the proportion that the amount of insurance bears to the valuation stated in the policy, it is essential that the declared value of the vessel be a fair one. Low valuations unfairly benefit the insured, since the proportion of the loss assumed by the underwriter increases as the declared valuation of the vessel is lowered.

In the case of damaged goods the adjustment may also involve very complex problems which it is not the purpose of this chapter to discuss. The customary procedure has been described as follows:⁶

The gross sound value of the goods at the port of destination is compared with their market value in the

⁵For a detailed statement of this and the foregoing rules, see Richards: "A Treatise on the Law of Insurance," p. 254.

⁶S. S. Huebner: "Marine Insurance," p. 95.

damaged state, and the term value is meant to include freight, duty, and other expenses necessary to place the goods upon the market in question. The percentage thus obtained is then applied to the amount of insurance under the policy. In addition the underwriter must also assume all expenses involved in the settlement of the loss. The sum thus ascertained will be paid by the underwriter on the coinsurance principle, i.e., in the proportion that the amount of insurance carried by the insured bears to the value of the goods. But should the insurance exceed the value of the goods, the underwriter is proportionately liable for more than the loss actually incurred. ✓

Salvage.—Salvage charges, according to the British Marine Insurance Act, refer to the “charges recoverable under maritime law by a salvor independently of contract,” and “do not include the expenses for services in the nature of salvage rendered by the assured or his agents, or any person in employ for hire by them, for the purpose of averting a peril insured against.” Salvage does not come under the “sue and labor clause” for the reason that the salvors were not in the service of the insured.

If the amount of remuneration cannot be determined by agreement between owner and salvor, it becomes necessary to have an admiralty court fix the same. In doing so the court will take into account the value of the property saved and the extent of the labor, risk, and expense involved. Until such salvage award is paid the salvor has either a “possessory lien” or a “maritime lien” on the property, depending upon whether or not it is in his possession. Salvage awards are usually apportioned over the values of the various interests saved, just as in the case of general average, and are recovered from underwriters in exactly the same manner, providing the contributing interests are insured.

CHAPTER XXVI

POLICY ENDORSEMENTS IN MARINE INSURANCE

Multitudinous Character of Such Endorsements.—

There is an almost endless variety of endorsements attaching to marine policies in order to express special agreements entered into by the contracting parties with a view to changing or supplementing the provisions contained in the printed form of the policy. Possessing so many phases as does marine insurance, it is only natural that the needs of both merchants and underwriters should require numerous modifications of ordinary policy provisions which were designed to apply only to a general situation. If fire insurance, with its single peril, requires the use of special endorsements, how much greater must be the need for such endorsements in marine insurance with its numerous perils affected by different conditions, its many types of vessels and hundreds of kinds of commodities varying greatly in their inherent characteristics, and its several types of losses and many methods of coverage.

How large the number of special endorsements in marine insurance is may be judged from the fact that each of a number of available collections makes a volume of several hundred pages.¹ To reproduce or describe them all is quite impracticable, so an attempt will be made

¹ Previous chapters refer extensively to a number of very important clauses, such as the "Sue, Labor and Travel Clause," the "Memorandum," "Collision Clause," "War Clause," "Disbursements Warranty," and "Inchmaree Clause." These and other clauses at one time took the form of endorsements, but their use became so general in recent years that they are now, as a rule, incorporated within the printed portion of the policy and are no longer regarded as constituting special agreements.

merely to indicate their nature by giving the principal groups under which they may be classified. These groups are nine in number, and with comparatively few exceptions comprise all of the endorsements now in use. The groups of endorsements referred to are those:

Varying the Memorandum.—The nature and importance of the customary memorandum clause in cargo insurance has already been noted. But numerous modifications of this arrangement, in the form of "average clauses," are used with respect to cargo and hull risks, and all have an important bearing upon the underwriter's liability, and consequently upon the rate of premium. Sometimes policies are endorsed "F. P. A." or "F. G. A.," meaning that the policy is "Free from Particular Average" or "Free from General Average," and that the underwriter's liability does not extend to one or the other of these types of losses. When particular average is covered the policy may provide that liability will only be assumed if the loss is due to certain specific perils like stranding, sinking, burning or collision. Or, the severity of the application of the memorandum percentages may be modified in the interest of the insured by sub-dividing the cargo or vessel into "series," so that the percentage of loss necessary to make the underwriter liable will apply to much smaller values, whereas under the ordinary memorandum the absolute loss represented by the franchise might be unduly large before the underwriter assumes liability, as for example, \$20,000 on a \$200,000 cargo under a 10 per cent limitation. Again, policies may be endorsed "free of particular average under per cent, which is deductible," thus greatly reducing the underwriter's liability, since it extends only to the excess portion of any loss over and above the stated percentage, whereas under the ordinary memorandum the underwriter becomes liable for the entire loss as soon as the stated percentage is reached.

Among the remaining average clauses, two have assumed great importance, namely, the "F. P. A. A. C. Clause" (Free of Particular Average American Conditions) and the "F. P. A. E. C. Clause" (Free of Particular Average English Conditions). Translated, the first of these clauses reads "free of particular average *unless* caused by stranding, sinking, burning or collision with another vessel," and the second "free of particular average unless the vessel or craft *be* stranded, sunk, burnt or in collision." The distinction between the two clauses lies in the difference between the words "*unless* caused by" and "unless the craft *be* stranded, etc.," and the legal construction placed by the courts upon these words. The difference has been explained as follows:²

Under the American form the underwriter is not liable for partial losses unless one of the four enumerated casualties has been the proximate cause. The English form, however, renders the underwriter responsible for partial losses which may be caused, previously or subsequently to the occurrence of one of the four stipulated hazards, by some casualty not at all related to stranding, sinking, burning or collision. In other words, should any one of the four casualties happen, even though in a technical sense, the underwriter stands to lose all protection under the clause for the balance of the voyage and will be responsible for partial losses occasioned by any of the numerous perils covered by the policy. A temporary stranding of only a few hours without the slightest injury to the cargo will nullify the clause for the remainder of the voyage and subject the underwriter to the ordinary provisions of the policy. Or it may happen that a heavy water damage is occasioned by stress of weather. If none of the four casualties occurs no portion of this loss is collectible. But assuming that subsequently there be a slight stranding or collision, automatically the clause will be changed into a "sub-

² S. S. Huebner: "Marine Insurance," pp. 108-109.

ject to average" insurance and the underwriter becomes liable.

Such an interpretation was certainly not the original intention of the framers of the clause. The interpretation given by the courts is regrettable, since it not only injects a serious speculative element into marine insurance, but is also apt to involve a moral hazard in that the insured, when owner of both the cargo and vessel, might, for example, effect a technical stranding with a view to changing his "free of average" insurance, obtained at a lower rate, into insurance which covers partial losses caused by any of the perils enumerated in the contract. These shortcomings are all the more unfortunate when we reflect that the English form is used much more widely than the American form. Its general use, however, combined with the desire to eliminate the possible effects of the legal interpretation referred to, has led to the adoption of numerous modified forms of the F. P. A. A. C. Clause, which have for their purpose the exclusion of partial losses caused by certain casualties.

Hull insurance also presents a great variety of average clauses. Often a minimum franchise of 3 or 5 per cent is applied to each valuation separately, as on the hull, fittings and machinery. Frequently, however, it is the practice to apply the percentage, or a stated amount, "on each valuation separately *or on the whole*." Deductible franchise clauses are also very common in hull insurance, and are often desired by the insured as a means of securing large lines of insurance at the lowest possible cost. In the case of very valuable ocean liners the deductible franchise at times involves an absolute amount of several hundred thousand dollars. In other instances the deduction is a percentage of the stated value, or a fixed amount per accident, like "\$500 on each accident." Average clauses in hull insurance also usually make reference to the substitution of new for old materials, the wording customarily

being: "Average payable on each valuation separately or on the whole, *without deduction of thirds, new for old*, whether the average be particular or general." At one time, when wooden vessels were in general use, it was found convenient to apply a "one-third deduction, new for old" as a means of off-setting the resulting improvement to the vessel, in the event of repairs, from the substitution of new materials for the old. Such a general rule, however, would prove very unfair in the case of modern steamers, and accordingly the deduction at present ranges all the way from nothing on the iron work of the vessel to one-third on certain fittings, in order to make the deductions correspond as nearly as possible to the actual facts. Sometimes the deductions are arranged according to a sliding scale, the amount increasing gradually as the age of the vessel, or the portion thereof under consideration, increases. Even with respect to wooden vessels, modifications are made in the case of anchors, chains, and other metal portions.

Exempting Underwriters from Certain Types of Losses and Expenses.—Thus endorsements on cargo policies may stipulate that the underwriter shall not be responsible for the loss of time; that no claim shall be made in general average arising from the loss or jettison of merchandise loaded on deck; that while goods are on railroad or other land conveyance, only the risks of fire, collision, derailment and loss occasioned by rising navigable waters are covered; that while goods are on wharf they shall be liable only for the risks of fire and rising navigable waters; that shipments of live stock are warranted free from mortality and jettison; and that liability is limited to a stipulated maximum for any one vessel or conveyance, or any one place, at any one time. Hull policies often contain special clauses that exempt the vessel from liability for contribution for jettison of deck cargo; warrant the insurance free from claim

in consequence from any prohibition, restriction, or embargo enforced by the government, or of any violation or attempted violation thereof; protect the underwriter against grounding in the Panama, Suez and Manchester canals or in certain designated rivers or ports; or exclude unrepaired damage in addition to a subsequent total loss sustained during the term covered by the policy.

Prohibiting, Restricting or Regulating the Carrying of Certain Commodities.—Such clauses are very numerous with respect to cargo insurance in many leading trades like fruit, refrigerated goods, hides and skins, dressed meats, machinery, etc. In hull insurance frequent use is also made of “loading warranties,” which limit or prohibit the loading of certain heavy or otherwise hazardous articles. The most widely known clause of this character warrants the vessel “not to be loaded in excess of her registered tonnage with either lead, marble, stone, coal or iron; also warranted not to be loaded with lime under deck; and if loading with grain, warranted to be loaded under the inspection of the surveyor of the Board of Underwriters, and his certificates as to the proper loading and seaworthiness obtained.” Other clauses prevent loading of certain articles altogether, and may take some such form as “warranted not to load or carry crude petroleum, naphtha, benzine or gasoline.”

Defining the Areas within which Insured Vessels May Operate.—Reference is had to so-called “trading warranties” that range all the way from those which permit the vessel to navigate on all waters without restriction to those which limit the vessel’s use to a limited area. In the latter case the policy is generally “warranted confined to waters and tributary thereto,” or the navigable area is specifically designated as “New York harbor to include upper and lower New York Bays, inside a line drawn from Sandy Hook to Norton’s Point, North River

as far as Piermont, East River as far as Throggs Neck, and tributary inland waters, and the adjacent inland waters of New Jersey." Similar clauses define the limits of Long Island Sound, Chesapeake Bay, Philadelphia Harbor, etc. The frequently used American or London Institute Warranties exclude certain waters in Northern or Arctic regions unless, with few exceptions, an extra premium is paid. Other warranties prohibit the carriage of certain cargo within certain months, or forbid navigation altogether on certain waters during a portion of the year. Of the latter class the restrictions on the Great Lakes traffic are probably the best example, sailing dates being limited to metal vessels between April 15th and December 1st, and for wooden vessels between May 1st and November 15th. But these restrictions are again subject to removal by special agreements conditioned upon an extra premium. A further so-called "Winter Moorings Clause" provides that Great Lakes vessels must be moored under conditions which meet with the underwriters' approval.

Defining the War Hazard, or Otherwise Modifying the Enumerated Perils.—Policies may be written either subject to or free from war hazards. But where the war hazard is assumed, it is often necessary to impose certain limitations. Thus during the recent war it was customary to endorse policies with some such clause as: "Warranted not to cover the interest of any partnership, corporation, association, or person, insurance for whose account would be contrary to the Trading with the Enemy Acts, or other statutes or prohibitions of the United States or British Governments." Other endorsements commonly met with were "warranted neutral," "warranted neutral ships and neutral property," "warranted free from British and Allied capture," "warranted to sail with convoy," "warranted no contraband of war," and "warranted free from any claim arising from capture, seizure, arrest, restraint,

preëmption or detainment by the British Government or their Allies." With respect to the perils clause, special endorsements are also used to free the underwriter from certain of the enumerated perils, or to impose special restrictions with regard to the same.

Relating to Valuation of the Subject-Matter of Insurance or Adjustment of Loss.—The so-called "valuation clause," for example, provides that "the sound value at the port or place of destination outward is to be deemed not to exceed the purchasing price at the shipping port, and ten per cent added thereto, exclusive of duty and freight." Proper notice of loss is often required by stipulating that, in the event of a partial loss on merchandise, the underwriter shall have notice of such damage within, say, eight days after the landing of the goods. In certain important trades the settlement of losses may be subject either to the "Loss in Weight," or the "Loss in Test" clause, the first meaning that the loss will be settled on the basis of the reduction in the weight of the cargo as shown by the weight records, while the second method requires the damage to be determined by a comparison of the sound with the damaged value.

Hull policies may require by endorsement that proofs of loss and all bills for expenses must be approved by the company, that the company shall have a voice in the selection of members of all boards of survey, and that notice shall be given the company, where practicable, prior to any survey, so that it may appoint its own surveyor, if it so desires. Constructive total loss is sometimes carefully defined with reference to the extent of expenditures before it may be assumed to exist. With respect to other losses it may be agreed that all sums paid under the policy shall reduce it by the amounts so paid, and that the policy will not be in force for the original amount unless restored by the payment of a new premium.

Extending Underwriters' Liability to Additional or Special Risks.—By no means all of the special endorsements are designed to limit the underwriters' liability. Numerous special agreements exist to give the insured protection beyond the limits customarily provided for in the ordinary policy. Thus the risk of lighterage to and from the vessel may be assumed, and a large variety of clauses relate to this important subject. Another clause extends the policy to cover customs duties chargeable upon the merchandise insured upon arrival and entry; while another provides that, should navigation be interrupted by ice, the vessel is at liberty to discharge the cargo at any neighboring port, the risk to continue until the safe arrival of the goods at their destination by land carriage or otherwise. Any of the numerous war risks may also be definitely assumed by the underwriter upon the payment of an adequate premium. Privilege may be given to lay up the vessel for purposes of making additions, alterations and repairs, and to go in drydock. Leave may be given to sail with or without pilots, to tow or to be towed, and to assist vessels in all situations and to any extent, and to go on trial trips. The underwriter may also agree to assume all risks of negligence, default or error in judgment of all parties with respect to navigation. Special clauses also exist extending the underwriters' liability to deck cargo, to loss by theft, pilferage and non-delivery, and to any or all of the risks already noted as coming under protection and indemnity insurance.

Defining the Duration of the Risk.—Numerous clauses are used to extend the underwriters' liability to risks existing prior to the loading of merchandise on the vessel, or subsequent to its unloading. "Shore cover" on the dock, either before loading or after unloading, may be granted for different periods of time and under various circumstances or conditions. At other times the insurance may

be made to apply from the time the transportation company receives and receipts for the goods. In still other instances the merchandise is protected throughout all the stages of a through shipment, including both land and water stages, as already explained in connection with the "warehouse to warehouse clause."

Waiving Important Marine Insurance Principles in the Interest of the Insured.—Attention has already been called to the importance of the implied warranty of seaworthiness of the vessel. Yet an endorsement may be agreed to whereby "seaworthiness of vessel and/or vessels and/or craft is hereby admitted as between underwriters and assured." With reference to negligence, the policy may provide by endorsement that "the presence of the Negligence Clause and/or Latent Defect Clause in bills of lading, and/or charter party," is not to prejudice the insurance. Other leading examples are agreements which fully admit insurable interest, which make the policy proof of interest; or which declare the insurance binding in case of deviation or change of voyage or of any omission or error in the description of the interest, vessel or voyage.

CHAPTER XXVII

MARINE INSURANCE RATES

Judgment Rating a Necessity in Marine Insurance.— Marine insurance companies follow the practice, pursued in other lines of insurance, of determining premium rates on the basis of averages arrived at through the tabulation of statistical experience on many risks of the same kind over a considerable number of years. Yet such data serves only as a basis, and must be supplemented by many factors which vary greatly under different conditions, and the importance of which, from an underwriting point of view, must be left to the underwriter's judgment. With but few exceptions there are no fixed rates in marine insurance. Probably no other branch of insurance is so dependent upon the ability of the underwriter to judge correctly a large number of variable factors. Life, fire, and most other kinds of insurance, relate to but one or a few hazards. Marine insurance, however, grants protection against a large number of perils, all of which must be viewed in their relation (1) to the inherent character of a large variety of subject-matters of insurance, (2) to the effects of seasons, adverse physical forces, and trade customs prevailing on innumerable routes of traffic, and (3) to an immense variety of special policy provisions. As stated elsewhere:¹

To a very large extent the business is inherently a system of estimates and the importance of the judgment and ability

¹ S. S. Huebner: "Marine Insurance," p. 181.

of the underwriter cannot be over-emphasized. A marine insurance rate is really a composite—a general judgment—of all the numerous factors which have a bearing upon the particular hazard underwritten. This necessity for comprehensive judgment accounts for the extremely limited number of expert underwriters in a new marine insurance market like our own. It has been one of the chief reasons for having the marine departments of a considerable number of companies placed under a single management. The absence of trained men has been responsible also for the unwillingness of many of our fire companies to enter the marine insurance business, while of those who have done so, many of the smaller companies confine themselves solely to the taking of risks (by way of reinsurance) accepted originally by some larger underwriter. Witnesses also testified during the recent marine insurance investigation² that leadership in the business is a very important factor, and that frequently other underwriters participate in a risk after various amounts have been taken by certain underwriters well known to the insurance community. In London, particularly, various underwriters are experts—leaders—in different trades, and acceptance of a portion of the risk by them will greatly facilitate the underwriting of the balance by others.

Importance of the Individual Insurance Account.—One of the most important factors in marine insurance rating is the personal element, i.e., the insured's individual record. This phase of the subject is unfortunately too little known or appreciated by the insuring public. "The personal equation," as stated by a leading underwriter, "enters into the making of marine insurance rates very materially. This is right and it should be so. There is a fallacy that has run through practically every bit of insurance legisla-

² Hearings on Marine Insurance before the Sub-committee of the Committee on Merchant Marine and Fisheries, House of Representatives, 66th Congress, 1st Session.

tion I have seen in the United States. There seems to be an obsession on the part of people when you insure a risk, a house or ship or anything of that kind, that things that have exactly the same physical hazard ought to have the same rate. You do not do anything of the kind. You insure a man against loss to that property, and while you take into consideration the construction of that property and its maintenance, it is the human element that is a very vital part of that rate making, and it should be so.”³

Under different managements two vessels alike in every respect may nevertheless require the application of entirely different rates. The one management, for example, may be efficient in the upkeep of the vessel and the appointment of officers and crew, and thus establishes for itself an excellent loss record among underwriters. The other, through negligence, indifference or undue economy, fails miserably in these respects and as a consequence shows a bad record. To treat these managements alike in the matter of marine insurance rates would be a rank injustice. Such treatment would penalize efficiency and carefulness and put a premium on inefficiency and carelessness. A difference in rates to meet the difference in quality of management can in no way be regarded as a discrimination. Premiums must in the long run depend upon results as shown by the insured's account, and should, therefore, be based on the record actually experienced. Similarly, with respect to cargo, it may happen that two separate owner-ships of the same kind of goods, conveyed on the same steamer at the same time and to the same place, will command different rates. Through proper packing and handling the one owner establishes a good record, whereas

³ Benjamin Rush, "Hearings on Marine Insurance before the Subcommittee on Marine Insurance of the Committee on Merchant Marine and Fisheries," pp. 183-184.

the other has a record, extending over a period of years, noteworthy for its numerous losses. Here, again, it is only just that underwriters should seek to adjust rates between owner and owner so that profitable accounts will not be penalized in order to make up the losses of losing accounts. In fact, the difference between insurance accounts may be such as to indicate the presence of dishonest dealing with the result that very high rates, or a refusal of insurance altogether, will inevitably follow. Numerous instances exist where the underwriter's statistical record will show an owner's insurance account to include many unnecessary and unfair claims, a practice often resorted to by those who, owing to slender profits in their business, have a tendency to use the insurance company as a source of enhancing their income. Mention should also be made of the practice whereby certain brokers combine a number of separate ownerships into a single insurance account with a view to compelling underwriters to accept the combined business at one rate of premium and on the basis of "all or none." When this is done repeatedly, underwriters are obliged to regard the profitableness or unprofitableness of the broker's account as a whole for rate making purposes.

Hull Rates.—*Natural forces and topography.*—Aside from the important factor of management, underwriters must also give consideration, when determining hull rates, to the character of the route, the construction, type and nationality of the vessel, and the conditions of the contract of insurance. The first of these factors is very important, since the laneways of commerce are by no means on a parity with respect to natural forces and topography. Some are comparatively free from natural hazards while others are known to present either permanent or seasonal dangers. Reference is had to storms, fog (a leading cause of collision and stranding), submerged shoals, shifting sand bars, shallow water, narrow channels, ice, icebergs, long nights, cur-

rents, tides, tidal waves and seaquakes. Nor is the open ocean voyage the only consideration. Often the greatest dangers, from an underwriting standpoint, are associated with the ports of departure, call, or destination. Some ports are known for their difficult approach, insufficient depth, absence of good anchorage ground, lack of protection against tides or tidal waves, and shifting sand bars or other obstructions. Others are favored with an absence of these menacing factors to commerce. Still others, although not thus favored, have overcome these hazards through dredging and the construction of break waters, tidal basins, anchorage buoys, etc.

Construction, type and nationality of the vessel.—The quality and fitness of the vessel to serve as a carrier on the particular route under consideration is naturally of the utmost importance. To arrive at a proper rate on the vessel, and the same may also be said of cargo rates, the underwriter will want to know the vessel with respect to its builder and owner, structural plan, material used in construction, type of propulsion, structural strength to resist stresses and strains, adaptability to carry various kinds of cargo, and its age and physical condition.

For the convenience of underwriters and shippers various so-called Classification Societies furnish the aforementioned information. These societies were organized for the purpose of promulgating rules for the construction of vessels, supervising such construction, assigning a "class" to each vessel, and publishing registers containing a detailed and classified description of the most essential features of all vessels coming within their jurisdiction. Nearly every vessel of any importance is classified to-day in some classification register, and assignment to a class, it should be noted, is based on the understanding that periodical surveys and necessary repairs shall be made as the Society may direct.

The leading classification registers of to-day are Lloyd's Register of British and Foreign Shipping, the Bureau Veritas of France, and the Record of the American Bureau of Shipping. The three registers referred to are similar in character, and Lloyd's register will serve for the purpose of illustration. Among other items, this register states, with respect to all vessels in the British merchant marine of not less than one hundred tons as well as numerous vessels of other countries, the name and nationality of the vessel, materials of construction, details of the decks, the engine and boiler equipment of the vessel, its dimensions and registered tonnage, and the date of the last survey. To keep the shipping world informed of any important changes, supplemental lists are published periodically in connection with the annual edition of the Register. In other words, this Register may be likened to a catalogue of nearly all the important vessels of the world, from which the underwriter may ascertain, by a hurried reference, the general fitness of a specified vessel to make a given voyage or carry a certain cargo. To render such reference on the part of the underwriter still easier, both iron and wooden vessels are divided into separate classes, and these classes into grades, each grade being designated by a code symbol. (For a specimen page of Lloyd's Register, see pages 416 and 417.)

Nationality of the vessel, it should be added, is important to underwriters in the sense that certain nations are mainly dependent upon ocean commerce and their citizens are essentially sea-faring people. On the average the masters and crews belonging to such nations constitute the most skillful mariners, a matter of great importance in times of distress when the underwriter's interests depend largely upon the quick and correct action of those in charge of the vessel. Again, rates may vary greatly as to the standard of commercial honor in trade, some possessing a high

standard, while others are known for their lack of commercial ethics, especially in connection with the presentation of unworthy claims.

Policy conditions.—As noted in the previous chapter, innumerable clauses are used to limit or increase the underwriter's liability. Some policies may cover against total loss only, while others provide for full coverage. Some policies may cover only partial losses; others may relate only to general average, or to particular average, or to particular average when caused by a limited number of specified perils. The variety of "average clauses," as already explained, is very great, there being deductible or non-deductible clauses, F. P. A. A. C. and F. P. A. E. C. clauses, etc. Again, the policy may contain trading warranties, loading warranties, etc. All of these varying policy conditions are carefully considered by underwriters since they have a vital bearing upon the hazard involved, and, therefore, upon the rate of premium charged.

Cargo Rates.—*Character of the commodity.*—In the main, the general factors just discussed with reference to hull rates, also underlie the determination of cargo rates, although the application will differ in certain particulars. Just as the underwriter must concern himself with the physical condition of the vessel, when insuring the same, so it is essential, in the case of cargo insurance, to recognize the inherent characteristics of the thousands of commodities that are offered as risks. The difference in hazard between various kinds of commodities, or even between different forms of the same commodity, is apparent. Sometimes different shipments of the same commodity may represent different methods of preparation or packing, which will vary in their effect upon the durability of the commodity in question from the standpoint of time, temperature, moisture, leakage, breakage, pilferage, etc. One article may be susceptible to the absorption of odors when

stowed near other commodities, while another article may be immune from this hazard. Certain articles may easily be damaged by salt water or exposure to the elements, while others remain unaffected in this respect. Some commodities are very perishable in character and would subject the underwriter to heavy liability in the event of a delayed voyage owing to an insured peril, while in the case of other commodities this factor may be ignored. Other groups of articles are susceptible to easy breakage and require the most careful loading, while still others can only be broken, crushed or damaged with difficulty. These are only a few of the many peculiarities of commodities that underwriters must be acquainted with in order to have their cargo rates, or their policy conditions, adequately reflect the hazard involved.

Hazards and customs connected with the particular route.—All of the factors previously mentioned in connection with hull rates under the heading of “natural forces and topography” must also be considered when insuring cargo. A few additional factors, however, remain to be mentioned. Thus the effect of seasons has a very important bearing upon commodities that are seriously affected by cold or heat. The influence of seasons upon cargo insurance has been explained as follows:⁴

An unforeseen delay in completing the voyage, owing to some marine peril, may produce, in view of the inherent nature of the commodity, a much greater loss in one season than in another. Again, the market for goods of a given type at the port of destination, or a port of refuge, may vary greatly according to the season of the year. Accordingly, in case of damage to such goods, the underwriter's prospect of realizing a fair salvage may be small or even negligible because of the limited need for such goods at

⁴ S. S. Huebner: “Marine Insurance,” p. 196.

that particular time. But the greatest hazard confronting the underwriter probably lies in the fact that many of the nation's leading products move most heavily to market at certain seasons of the year, as for example, cotton during the "cotton moving season." At such times enormous values are concentrated in a single locality under exceptionally bad conditions. The great congestion of freight materially increases the fire hazard to the goods as well as to the vessels lying at the dock. There is also a tendency at such times to overload the vessel and unduly to overcrowd passageways and other open spaces, thus rendering more difficult the mastering of a fire aboard the vessel. Moreover, heavy seasonal movements, especially when tonnage is scarce, often furnish an inducement for the entrance of vessels in the trade which are not at all adapted for the purpose. So well is this seasonal hazard understood that underwriters have organized associations which have for their purpose the supervision of the loading of vessels during the seasonal period of heavy traffic.

Varying trade customs and national characteristics, associated with different commercial routes, will also influence cargo rates materially. Reference is had to the difference in the methods of preparing, packing, loading and unloading of commodities that prevails in different markets. Some routes in particular, require lighterage or trans-shipment, or both, and thus greatly increase the chances of loss or damage to cargo. The moral hazard is also much greater on certain routes than on others, as, for example, the pilferage hazard, where the rates relating to certain markets are ten times or more the rates charged elsewhere.

Quality and suitability of the vessel used as carrier.—Under all circumstances, the underwriter must take into account the fitness of the vessel to carry the particular cargo offered to him as a risk. Liners, owing to their greater speed and special equipment to meet the needs of trade on the route they serve, will usually justify the charge

of a lower premium on the cargo carried than in the case of tramp steamers. The slower speed of the latter means a longer exposure of the cargo to the perils of the sea. Yet in the case of non-perishable commodities which may be transported in bulk, such a vessel will be eminently satisfactory in meeting the requirements of speed and economical transportation. In the case of highly perishable goods, moving in large quantities, special types of vessels have been designed to carry such commodities. Thus refrigerator steamers are especially adapted to the carrying of fruit and meat products. The effect of such vessels upon insurance rates for highly perishable commodities is very material, since loss through delay in the voyage, occasioned by an insured peril, is largely removed.

Duration of the voyage and policy conditions.—In insuring cargo, underwriters must give thought to the length of time during which the risk is assumed. Sometimes the insurance commences only with the loading of the goods aboard the vessel. At other times it extends to the protection of the goods while on the dock. In still other instances, the coverage extends from warehouse to warehouse. Again, the sea voyage may be several times as long in one case as in another. All of these factors, however, may be modified in their seriousness to underwriters by numerous special policy conditions, similar in character to those already discussed in connection with hull rates.

Operating Record of the Carrier as a Factor in Cargo Rates.—The above factors by no means represent all the considerations that must be taken into account to determine cargo rates. Numerous additional factors relate to the operating efficiency—the proved experience over a sufficient period—of the particular steamship line employed to carry the cargo on which insurance is desired. Reference is had particularly to the character and efficiency of the operating personnel, methods of handling and stowing cargo, the

regularity of the service, the form of bill of lading used, the degree of willingness to settle just claims arising from the carrier's negligence, and the extent to which claims have been presented for payment in the past.

With respect to their operating record, underwriters follow the practice of grouping steamship lines into classes on the basis of merit, and insurance rates on cargo transported by any given line will vary accordingly. Lines are usually grouped as either "approved" or "unapproved," and approved lines, in turn, are usually further subdivided into classes "A" and "B," and sometimes into even three classes. New lines, without any past record to present, are not given an approved classification until they have actually demonstrated a good record over a sufficiently long period of time, usually from four to five years. Underwriters assert, however, that where an experienced operator starts a new line, approved liner rates on cargo will be granted much more quickly, and, in fact, may be granted at once.

Under such a system it is apparent that an approved line has an advantage over an unapproved one. Estimates of underwriters indicate that the average differential in rate, due to this factor, ranges from 5 to 20 cents per \$100 of insured value, depending upon the nature of the cargo and other factors. This differential must usually, under competitive conditions, be absorbed by the carrier in its freight charges.

Marine Insurance Rates Subject to International Competition.—As contrasted with other forms of insurance, ✓ the marine insurance market is essentially international in character. In addition to all the foregoing factors American underwriters are obliged at all times to adjust their hull and cargo rates with a view to meeting the competitive rates of foreign underwriters. Fire insurance rates, as we have seen, are fixed and enforced by coöperative action

through underwriters' associations. The proportion of American fire insurance written by non-admitted foreign underwriters is also much less than the proportion of marine insurance (estimated at fully 25 per cent) placed in the foreign market. In marine insurance, as contrasted with fire insurance, rates are anything but fixed. Brokers have for years acted as freelances in the business, and make it a point to canvass the world market with a view to obtaining the most favorable rates for their clients. Competitive conditions, largely of an international character, have prevailed to such an extent that all past efforts of underwriters to effect coöperative arrangements for the purpose of stabilizing rates have either failed or been confined to the mere recommendation of rates without any definite obligation for their enforcement. Not only have foreign competing underwriters been given easy access to our domestic market but the exportation of marine insurance, originating in the United States, to non-admitted foreign underwriters is freely permitted and is taking place on a stupendous scale. Marine insurance rates, in other words, are subject to foreign under-cutting. Merchants and vessel owners, obliged to meet international competition in the world's markets, have always emphasized the importance of being allowed to place their insurance in the foreign market if that is cheapest. Moreover, the consignee in foreign trade transactions, actuated either by a desire to obtain the lowest rates or to patronize the companies of his own country, will often dictate where the insurance shall be placed.

SPECIMEN PAGE OF LLOYD'S REGISTER LLOYD'S REGISTER STEAMERS.

MAU-MAX

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
No. in Book	Steamer's Name, Material, Rig, &c	Regist'd Tonnage	Particulars of Classification	When last seen	By Whom	Where	Owners	Regist'd Dimensions, Deck, Beam, &c	Port of Registry	No. & Dia. of Cylinders—Stroke	Engines	Registered weight in tons	Depth	Remarks
Official No.	Master	Under Deck	Character	When last seen	By Whom	Where	Owners	Length	Beam	Depth	Flag	No. & Dia. of Cylinders—Stroke	Engines	Registered weight in tons
Code Letters	Special Surveys	No. of Decks, &c	Net	When last seen	By Whom	Where	Owners	Length	Beam	Depth	Flag	No. & Dia. of Cylinders—Stroke	Engines	Registered weight in tons
823	Maunusson	SteelScK (Trailer)	249		1905	Smith's	O. Dahl	125-6 | 22-0 | 12-1	La Rochelle	T.3Cy.12 1/2" 30" 34" 35"	58NEP	13	13	V
KCMB	Machifouz	1Dk	68			North Shields		Q51 F51	French	Shields Eng Co. Ltd. N.S.				
824	Maun	SteelScK	271-4-100A1	7.12	1906	Smith's	Wyre Steam	130-6 | 22-0 | 12-2	Fleetwood	T.3Cy.12 1/2" 31" 34" 35" (c)	58NEP	13	13	
12747	W Freshney	as Fit. No. 1-10	240		10mo	Dock Co. Ltd.	Wyre Steam	Q72 F51	British	180B N815				
HJLN		1Dk	151			N. Shields	Wyre Steam	as 71"	as 71"	Shields Eng Co. Ltd. N.S.				
825	Mauna Kaa	SteelScS	1566		1908	Union Iron Works	Inter Island Steam	239-3 | 36-2 | 16-7	Honolulu	T.3Cy.24" 37 1/2" 48" 39"	240NEP	13	13	
20423	W. Freeman	2Dks	977			S. Francisco	Nav. Co. Ltd.		Ud. States	Union Iron Works S. Fr.				
KWMI	Elec. light		940			Port Blakeley	Nav. Co. Ltd.		Honolulu	T.3Cy.15 1/2" 30" 45" 39"	100NEP	13	13	
826	Mauna Loa	WoodScS	851		1896	Hall Bros.	Inter Island Steam	176-8 | 33-9 | 16-1	Honolulu	T.3Cy.15 1/2" 30" 45" 39"	100NEP	13	13	
7728	C. Pedersen	(or James Spiers)	836				Nav. Co. Ltd.		Ud. States	Fulton E. & S. B. Wicks S. Fr.				
KQBV	Elec. light	1Dk & AwngDk	4952		1899	Chicago	Pittsburgh S. S. Co.	430-0 | 50-2 | 24-0	Duluth, Minn.	Q. Cy. 17" 37" 42" 45" 43"	285NEP	13	13	
827	Maunaloa	SteelSc	4781			Chicago	Pittsburgh S. S. Co.		Ud. States	Chicago S. B. Co. Chicago				
9274	Elec. light	Nchy. Aft.	4004			Chicago	Pittsburgh S. S. Co.		Ud. States	Q. Cy. 24" 33 1/2" 40" 47" 45"	34	34	34	
828	Maunganui	SteelViasScR	7527-4-100A1	Ddn b+	1911	Fairfield	Union S. S. Co. of New Zealand Ltd.	430-8 | 53-7 | 31-2	London	Q. Cy. 24" 33 1/2" 40" 47" 45"	194NEP	13	13	
17810	L. C. H. Worrell	as Fit. No. 1-10	7022		12mo	Co. Ltd.	Union S. S. Co. of New Zealand Ltd.	as 71"	as 71"	280B N815				
TVSD	Ref. Mchy. & Wireless	1Dk & AwngDk	4942			Chicago	Union S. S. Co. of New Zealand Ltd.	as 71"	as 71"	Shields Eng Co. Ltd. N.S.				
829	Maur	SteelScS	10099		1911	Tridhins	D. Barty & B. B. B. B.	133-9 | 31-8 | 11-0	AP T1401	T.3Cy.17" 37 1/2" 48" 39"	116NEP	13	13	N
MGIV	J. Sennar - 11	1Dk	649			Mek. Verka	D. Barty & B. B. B. B.	226-4 | 36-5 | 15-4	Rio de Janeiro	T.3Cy.17" 37 1/2" 48" 39"	116NEP	13	13	N
830	Maurenger	SteelScS	1024		1906	Stavanger	H. Westfall Larsen	225-3 | 32-1 | 13-3	Bergen	T.3Cy.16" 36" 43 1/2" 39"	103NEP	13	13	
MC5W	P. Trondalen-06	1Dk	628			Stavanger	H. Westfall Larsen	225-3 | 32-1 | 13-3	Bergen	T.3Cy.16" 36" 43 1/2" 39"	103NEP	13	13	
831	Maureen	SteelScS	2470-4-100A1	Sld t	1904	S. P. Austin	Marquess of Londonderry (D.N. Glinnes, Mgr.)	310-1 | 44-2 | 20-3	Sundstrand	T.3Cy.27" 37 1/2" 48" 39"	24NEP	13	13	
11805	M. Adamsen - 10	as Sld No. 2-13	2288		10mo	& Son, Ltd.	Marquess of Londonderry (D.N. Glinnes, Mgr.)	as 71"	as 71"	180B N815				
HBMG	1Dk up Iron & pl. Sld & W. W. frame	1Dk	1076			Stavanger	Marquess of Londonderry (D.N. Glinnes, Mgr.)	as 71"	as 71"	Shields Eng Co. Ltd. N.S.				

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PART III

**AUTOMOBILE INSURANCE, FIDELITY AND
SURETY BONDING, TITLE INSURANCE,
CREDIT INSURANCE, AND MISCEL-
LANEOUS FORMS OF PROPERTY
INSURANCE**

CHAPTER XXVIII

AUTOMOBILE INSURANCE

Extent and General Nature.¹—No other form of insurance has had so remarkably rapid a development as automobile insurance. Scarcely recognized among the miscellaneous kinds of insurance fifteen years ago, its growth has been almost as astonishing as the increasing use of the automobile itself. At the close of 1920 there were approximately 9,000,000 cars registered in the United States, or about one for each third "statistical family." During the same year 424 insurance companies wrote automobile insurance of some kind, with an aggregate premium income of about \$185,000,000.

Automobile insurance comprises five distinct types of coverage, namely, those pertaining to public liability, property damage, collision damage, fire and transportation hazards, and theft. Public liability insurance is transacted almost exclusively by casualty companies, and the fire, transportation and theft coverages almost entirely by fire and fire-marine companies. The property and collision damage forms are written by both types of companies, casualty companies probably being the most important with respect to the first type, and fire and fire-

¹The reader is also referred to the chapter on "Automobile Insurance" in Riegel and Loman's "Insurance Principles and Practices." For rules, rates, list prices, and symbols, relating to the various types of coverage, the reader is referred to (1) the "Automobile Insurance Manual for Fire and Transportation, Theft, Collision, and Property Damage," effective May 1, 1922; and (2) the "Condensed Rate Pamphlet" of the "1922 Automobile Casualty Manual," containing public liability, property damage and collision rates for private passenger and commercial automobiles, effective April 15, 1922.

marine companies securing most of the collision risks. The American mono-line system of insurance, limiting casualty and fire and fire-marine companies to particular kinds of risks, has been largely responsible for this division of the business. To an increasing extent, however, the managements of various companies within each class are organizing coöperating subsidiary companies, and are thus enabled to issue combination policies comprising all of the five types of coverage.

The significance of complete coverage, from a premium point of view, may be illustrated by reference to three types of cars. Thus on a new touring Ford, the aggregate premium for all types of coverage in New York City, subject to a \$50 deduction for all collision claims, and the ordinary limits for public liability and property damage, is \$201.29, or an amount equal to nearly 45.5 per cent of the list price of \$443. In Philadelphia the premium for complete coverage is \$136.79. For a five passenger touring Buick (list price \$1,395) and a seven passenger touring Packard (list price \$3,850) the aggregate premium in New York City for all types of coverage, under the aforementioned conditions, is \$335.87 and \$447.38, respectively, and in Philadelphia \$252.37 and \$321.88.

Public Liability Coverage and Leading Conditions Governing the Same.—This type of policy indemnifies the insured against loss from the liability imposed by law for “bodily injuries (or death resultant at any time therefrom) accidentally suffered or alleged to have been suffered by any person or persons during the term of this policy, resulting from the ownership, maintenance and use, including loading or unloading of any of the automobiles described in the declarations, at any location within the United States or Canada.” The company also agrees to: (1) “defend, in the name and on behalf of

the insured, all claims or suits for such injuries or damage for which the insured is, or is alleged to be liable"; (2) "pay all costs and expenses incurred with the company's written consent"; (3) "pay all court costs taxed against the insured in any such suit"; (4) "pay all interest accruing upon any judgment in any such suit"; and (5) "repay to the insured the expense incurred in providing such immediate surgical relief as is imperative at the time of the accident."

The ordinary limits of the public liability policy are \$5,000 on account of bodily injuries to one person, and, subject to the same limit for each person \$10,000 for any one accident injuring more than one person. These limits may, however, be increased for an additional premium. The policy covers "as additional insured any person, firm or corporation not covered by other insurance against a claim hereunder who is responsible for the operation of any automobile described in the declarations and also any person or persons while riding in or legally operating any automobile with the permission of the named insured or with the permission of an adult member of the insured's household who is not a chauffeur or domestic servant, except as limited by endorsement attached hereto." No liability exists, however, while the car is used for hire, or is engaged in any race or speed test, or is driven by any person under legal age or under the age of sixteen years, or is being used for towing or propelling any trailer. Nor does the policy cover any liability (1) imposed by any workmen's compensation law or agreement, (2) assumed voluntarily by the insured, or (3) incurred by the insured with respect to any employee while engaged in the maintenance or use of any automobile. In the event of the insured's bankruptcy or insolvency, the policy expressly provides that the company shall not be released from the payment of

indemnity arising under its terms. (For specimen copy of public liability policy see p. 442.)

Property Damage Coverage and Leading Conditions Governing the Same.—This type of insurance is invariably written in conjunction with either the public liability or the fire coverage, usually with the former. It promises to indemnify the insured against loss from the liability imposed by law upon the insured for property damage to other parties, of every description, "including loss of use of such property damaged or destroyed," resulting from the ownership, maintenance or use of the insured car. All legal costs, as already explained for the public liability coverage, are also assumed.

With few exceptions, the property damage coverage is governed by the same provisions as apply in the case of public liability insurance. Liability, however, does not extend to damage to any property of the insured, or "to the property of others used by or in charge of the insured or of any of his employees or carried in or upon any of the insured's automobiles." Nor is any liability assumed for loss by fire from any cause. The customary limit of liability for damage to property, including "the actual money loss by reason of the loss of use of the property damaged or destroyed," is \$1,000 for any one accident. This limit, however, may be increased for an extra premium. It is also understood that the limit of liability, and the same is also true with respect to public liability, shall not apply to the cost of defense of claims or suits, court costs, or interest accruing upon any judgment. (For specimen copy of property damage policy see p. 442.)

Factors Governing Public Liability and Property Damage Rates.—*Type of car and motive power.*—The method of arriving at rates for these two forms of coverage is the same, and involves five main considerations. One of

these relates to the type of car and motive power. In fact, with respect to all five types of automobile coverage, motor vehicles are divided into four general classes, namely, (1) "private passenger automobiles," or those used for pleasure and/or business purposes, but not including renting and livery work, carrying passengers for hire, regular and frequent commercial delivery, or the business of demonstrating or testing; (2) "commercial automobiles," or those of the truck or delivery type used primarily for the transportation or delivery of merchandise and other business uses, but not including the carrying of passengers for hire or the business of demonstrating or testing; (3) "public automobiles," or those used to carry passengers for hire, including private and public livery automobiles, taxicabs, hotel omnibuses, jitneys and buses; and (4) "automobile dealers and manufacturers," including automobiles operated by public garages, sales agencies and service stations, and automobile manufacturers or schools. Owing to the smaller hazard involved, electric cars of any of the aforementioned four types, as well as motorcycles, are written at rates lower than those charged for gasoline or steam cars.

Territory.—Using private passenger automobiles as the basis for our discussion, attention should first be called to the division of the United States into 8 territories, ranging from the most hazardous, like New York City (No. 1 territory), to strictly rural communities (No. 8 territory). Population density and past experience constitute the principal factors underlying the territorial grouping. ✓

List price.—Reference to the sample table of rates on page 426 shows a four-fold classification of cars, based on the "list price" and past experience. The "class symbols" range from W to Z, the last symbol representing the most hazardous class.

SAMPLE PAGE OF PUBLIC LIABILITY AND PROPERTY DAMAGE RATES

(Taken from Automobile Insurance Manual, effective May 1, 1922, and Condensed Rate Pamphlet of the 1922 Automobile Casualty Manual, effective April 15, 1922.)

PUBLIC LIABILITY RATES

**Private Passenger Automobiles
(Gas or Steam)**

BASIC COVERAGE

Terr.	Symbol W	Symbol X	Symbol Y	Symbol Z
1.....	\$100	\$119	\$144	\$176
2.....	55	65	79	97
3.....	47	56	68	82
4.....	38	45	55	67
5, 5A....	28.50	34	41	50
6.....	23	27	33	40
7.....	17	20	25	30
8.....	12	14	17	21

PROPERTY DAMAGE RATES

**Private Passenger Automobiles
(Gas or Steam)**

BASIC COVERAGE

Terr.	Symbol W	Symbol X	Symbol Y	Symbol Z
1.....	\$22.50	\$25.00	\$29.00	\$33.50
2.....	15.50	17.50	20.00	23.00
3.....	15.00	16.50	19.00	22.00
4.....	13.00	14.50	16.50	19.50
5, 5A....	10.00	12.00	13.50	15.50
6.....	10.00	12.00	13.50	15.50
7.....	8.00	10.00	11.00	12.00
8.....	6.00	7.00	8.00	9.00

Restricted coverage.—The aforementioned sample table refers to “basic coverage.” Two similar tables give all the rates, reduced 8 per cent and 20 per cent, respectively, for “8 per cent restricted coverage” and “20 per cent restricted coverage.” Basic coverage refers to cars operated by any person for pleasure and business purposes. Under the 8 per cent restricted coverage the insured agrees to use the insured car only for private personal pleasure, including going to and from residence and place of business but excluding commercial delivery or regular and frequent use for business or professional calls. The car, however, may be driven by the owner, members of his family, and chauffeur, or by any other person (for the abovementioned purposes) with the permission of the owner. Where the car is owned by one person, and is operated solely by this owner for private purposes, the coverage is regarded as “20 per cent restricted,” and all basic coverage rates are reduced by that percentage.

Increased limits and additional coverage.—Previous reference has been made to the ordinary public liability limits of \$5,000 and \$10,000 and the property damage limit of \$1,000. Both limits may be increased for an extra premium. Thus the public liability limits may be doubled (increased to \$10,000 and \$20,000) for a rate equal to 120 per cent of that charged for the ordinary limits. For limits of \$20,000 and \$40,000 the ordinary rates are increased by only 33 per cent. Similarly, the rate for a \$1,000 property damage limit will be increased by only 15 per cent, 30 per cent and 35 per cent if the limit of liability is increased to \$2,000, \$5,000 and \$10,000 respectively. For an extra premium, tourists may also secure public liability and property damage protection outside the United States and Canada.

Referring to our previous illustrations, the public

liability and property damage rates on a new touring Ford (private passenger car, territory 1, group symbol "W," basic coverage, ordinary limits) are \$100 and \$22.50 respectively. In territory 8 the corresponding rates are only \$12 and \$6. Under similar conditions the two rates for a new five passenger touring Buick (group symbol "X") are \$119 and \$25 in territory 1, and only \$14 and \$7 in territory 8. For a seven passenger touring Packard (group symbol "Z") the rates are \$176 and \$33.50 in territory 1, and \$21 and \$9 in territory 8.

Rates for other classes of automobiles.—In rating commercial cars the territorial division, noted for private passenger automobiles, is also used. Cars are divided into four classes, numbered 1, 2, 3 and 4, depending on the business (59 distinct uses being listed in the 1922 manual) of the insured. Each of these groups is again subdivided into three classes, depending on the load capacity of the car, namely, "heavy" (with a load capacity over $3\frac{1}{2}$ tons), "medium" (over 1 ton but not over $3\frac{1}{2}$ tons), and "light" (1 ton or less). Thus in territory 1, class 1, heavy load capacity, ordinary limit of liability, the public liability rate is \$456 and the property damage rate \$135; whereas in territory 8, class 4, light load capacity, ordinary limit, to use the other extreme, the corresponding rates are only \$22 and \$11. For commercial electrics all public liability and property damage rates, as quoted for gas and steam cars, are reduced by 25 per cent.

Public automobiles, rated on the basis of the same territorial classification, are divided into the following groups: private livery, public livery, taxicabs, school buses, hotel omnibuses, and jitneys and buses with a designated seating capacity. The last group, in turn, is divided into four classes depending on the seating capacity, namely, 12 or under, 13 to 20, 21 to 30, and

over 30. The public liability and property damage rates for taxicabs, for example, in territory 1, are \$480 and \$120 respectively; while in territory 8, the other extreme, they are only \$125 and \$35. For buses with a seating capacity in excess of 30, the corresponding rates are \$840 and \$135 in territory 1, and \$600 and \$80 in territory 8.

Rates for manufacturers' and dealers' cars are based upon any one of three plans, namely, "named chauffeur," "specified car," or "garage pay-roll." The aforementioned territorial division, it should be stated, is used in connection with each of the three plans. With respect to the first plan, the premium depends upon the number of chauffeurs declared in the policy. Under the second plan, the insured cars are listed, and are given the same rates as would apply to chauffeurs under the first plan. "Garage pay-roll" rates are divided into four classes, the "1st rate" applying to the first \$10,000 of pay-roll, the "2nd rate" to the excess of \$10,000 up to \$25,000, the "3rd rate" to the excess of \$25,000 and up to \$50,000, and the "4th rate" to the excess over \$50,000. For "total exposure," comprising "general liability coverage in addition to automobile coverage on any or all automobiles operated in the insured's business," the four classes of rates for public liability are \$3.75, \$3.00, \$2.25 and \$1.50 per \$100 of pay-roll in territory 1, and \$1.30, 95 cents, 70 cents, and 65 cents in territory 8. The corresponding property damage rates in territory 1 are \$1.25, \$1.00, 75 cents and 50 cents, and in territory 8, 60 cents, 45 cents, 35 cents and 30 cents. For "inside exposure" only, referring to "public liability accidents caused by automobiles while on the premises of the insured and adjacent sidewalks only," the rates are based on the aforementioned plan, but, owing to the much smaller hazard, are greatly reduced.

Collision Coverage.—*Definition of the coverage and leading conditions governing the same.*—Under this form of coverage the company agrees “to indemnify the insured against actual loss or damage by reason of injury or destruction” to any automobile described within the policy (including its operating equipment while attached thereto) “during the term of the policy solely by accidental collision with any other object, either moving or stationary.” The company’s liability, it should be noted, is limited to “the actual cost of suitable repairs or replacement or actual value at the time of the accident.” The following losses are also excluded from the coverage: (1) those occurring outside the geographic limits prescribed by the policy, like the United States and Canada; (2) “injury or destruction by fire from any cause whatever”; (3) “injury to or destruction of tires due to puncture, cut, gash, blow-out or other ordinary tire trouble”; (4) loss or damage of any kind to tires unless “caused by an accidental collision which also causes other injury or destruction to the insured automobile”; and (5) loss or damage occurring while the insured automobile is being operated in any race or speed contest or while being operated by any person under the age limit fixed by law or under the age of sixteen years. Should the company and the insured disagree as to any loss, damage or repairs, the same may be determined by two appraisers as set forth by the terms of the contract. The company has the option of repairing the damage, or of replacing the automobile or its equipment, or of paying in money the amount of the loss or damage determined by the appraisers. (For a copy of the collision agreement see p. 448.)

Collision coverage is written under three main forms. Under the “full coverage” or “non-deductible” form, the company settles to the full extent of the cash value, repairs or replacement cost. In contrast to such full coverage, how-

ever, there are the "\$50 deductible" and "\$100 deductible coverages." Under this type of coverage, to quote the endorsement, "each claim hereunder shall be adjusted separately and from the amount of each claim when determined the sum of fifty dollars" (or \$100 in case of the \$100 deductible coverage) "shall be deducted and the company shall be liable for loss in excess of that amount only."

Factors underlying the determination of rates.—Collision rates depend upon the degree of coverage (whether full, \$50 deductible or \$100 deductible), the collision symbol, the territory under consideration, the age of the car, the type of car, the motive power, and the presence of approved bumpers and radiator guards. The sample rate table appearing on page 432 gives the collision rates for private passenger automobiles, (gas or steam) for territories 1 and 2. Similar pages of rates have been compiled for all of the other eight territories (as previously described) into which the country is divided.

An examination of the sample rate page shows that private passenger automobiles are symbolized alphabetically from "A," for the smaller and less expensive cars, to "U" for the larger and costlier cars. From the standpoint of age, automobiles are classed into five groups, group 1 comprising automobiles "purchased new this calendar year," group 2 relating to cars purchased "new last year," while groups 3, 4 and 5 refer to cars purchased, respectively, "new two years ago," "new three years ago" and "new four or more years ago." Thus the collision premium rate for a touring Ford, with a 1922 list price of \$443, is \$179 in territory 1 under a "full coverage policy." Under the \$50 and \$100 deductible coverages, however, the rates are only \$46 and \$24 respectively under the same conditions, thus showing the great importance of this particular factor. Under similar conditions, the rates for the three degrees

SAMPLE PAGE OF COLLISION RATES

(Taken from Automobile Insurance Manual, effective May 1, 1922, p. 355)

COLLISION RATES—PRIVATE PASSENGER AUTOMOBILES—GAS OR STEAM—TERRITORIES 1 AND 2

Coll. Symbol	FULL COVERAGE					\$50 DEDUCTIBLE					\$100 DEDUCTIBLE				
	1	2	3	4	5	1	2	3	4	5	1	2	3	4	5
A.....	\$179	\$166	\$158	\$154	\$141	\$46	\$43	\$41	\$39	\$36	\$24	\$23	\$21	\$20	\$20
B.....	205	190	181	174	162	56	52	49	48	43	25	24	23	21	20
C.....	245	227	214	208	192	76	70	66	64	59	29	28	27	25	24
D.....	274	253	240	234	214	91	84	80	78	71	37	35	32	31	29
E.....	296	274	261	251	232	109	101	97	92	85	45	43	40	39	36
F.....	312	288	274	266	245	127	118	112	108	99	53	49	47	45	41
G.....	320	296	282	272	251	143	132	125	120	112	63	59	55	53	49
H.....	333	307	291	283	261	160	148	141	136	126	75	68	65	63	59
J.....	342	317	301	291	269	176	164	155	150	139	88	81	77	75	69
K.....	354	328	312	301	278	190	176	167	162	150	99	91	87	84	77
L.....	365	338	320	310	286	199	185	175	169	157	108	100	95	92	85
M.....	371	344	326	315	291	209	193	183	176	164	119	109	104	101	93
N.....	376	349	331	320	296	214	199	188	182	168	127	117	112	108	100
O.....	378	350	333	322	298	217	202	190	185	171	136	125	119	115	107
P.....	381	352	334	323	299	220	204	193	188	172	143	132	125	121	112
Q.....	382	354	336	325	301	225	209	197	192	176	152	141	135	129	120
R.....	387	358	339	330	304	228	210	200	193	179	160	148	140	136	125
S.....	390	362	342	331	307	231	213	203	196	181	165	153	145	140	129
T.....	394	365	346	334	309	234	216	206	199	183	168	156	148	143	132
U.....	395	366	347	336	310	237	218	209	202	186	171	159	151	145	135

The above rates shall be reduced 25% for electrics.

For bumper discounts, see list approved bumpers and form of endorsement required.

of coverage for a five passenger touring Buick (1922 list price of \$1,395) are \$312, \$127 and \$53 respectively; and for a seven passenger touring Packard (1922 list price of \$3,850) \$371, \$209 and \$119. Combining all the factors of territory, collision symbol, age group and degree of coverage, private passenger automobile collision rates vary from a minimum of \$10 (for territory 8, collision symbol "A," age group five, \$100 deductible) to \$395 (for territory 1, collision symbol "U," age group one, full coverage). In the case of electric cars the rates quoted for gas and steam passenger cars are reduced by 25 per cent.

In rating commercial cars the aforementioned territorial division is also used, the rates again varying according to the three degrees of coverage. Twenty collision symbols for complete commercial cars (chassis, body and equipment) are used, ranging from "AA" to "UU." Combining all the factors of territory, collision symbol, age and coverage, the rates vary from a minimum of \$10 (territory 8, age group 5, collision symbol AA, \$100 deductible) to a maximum of \$443 (territory 1, age group 1, collision symbol UU, and full coverage). Electric commercial cars are written at rates reduced by 25 per cent. With respect to certain classes of commercial cars—ambulances, baggage transfer, emergency cars of electric light, street railway and similar public service corporations, mail trucks, and automobiles operated by express companies, fire departments, fire patrols, police patrols, and newspaper delivery services—all rates are increased by 100 per cent.

In the case of private livery automobiles rates are equal to 150 per cent of the corresponding private passenger collision rates, while public livery automobiles, taxicabs, hotel omnibuses, jitneys and buses are written at twice the corresponding private passenger rate, if the public automobile is of the private passenger type, and at twice the corresponding commercial automobile collision rate if the

public automobile is of the bus or commercial automobile type.

Dealers' and manufacturers' automobiles, or any other automobiles used for demonstrating or testing purposes, are written for collision insurance at the private passenger rates applicable, plus 25 per cent. A discount, however, is allowed to a dealer insured under a blanket collision policy for all new automobiles owned by him during the policy year. Thus where the dealer owns less than 100 new cars during the policy year, the rate charged is only 40 per cent of the full private passenger or commercial rate applicable. Where the number of new cars thus owned exceeds 100 but is less than 250, the rate is reduced still further to 35 per cent, and where the number of new cars owned exceeds 250 to only 30 per cent.

Special "bumper allowance endorsements" are used in connection with collision insurance and usually read to the following effect: "In consideration of the reduced collision premium charged, it is warranted by the insured that the automobile insured under this policy is and will be continuously equipped with a front bumper known as and manufactured by The insured undertakes to use all diligence and care in maintaining the efficiency of said bumper throughout the life of this policy. The bumper allowance is granted only where the automobile is equipped with a bumper of make and type which has been approved by the Underwriters' Laboratories, Inc." With respect to private passenger cars, equipped with a front bumper of approved type, an allowance of 10 per cent from the collision premium is granted. When equipped with both front and rear bumpers the allowance is increased to 12½ per cent. On commercial automobiles a discount of 5 per cent is allowed for the attachment of an approved front bumper and/or an approved radiator guard.

Fire and Transportation Coverage.—*Definition of the coverage and leading conditions governing the same.*—This type of automobile policy protects “against direct loss or damage, from the perils insured against, to the body, machinery and equipment of the automobile described herein while within the limits of the United States (exclusive of Alaska, the Hawaiian Islands and Porto Rico) and Canada, including while in building, on road, on railroad car or other conveyance, ferry or inland steamer or coastwise steamer between ports within said limits.” The following are the perils insured against: (1) “fire, arising from any cause whatsoever and lightning”; and (2) “while being transported in any conveyance by land or water, the stranding, sinking, collision, burning or derailment of such conveyance including general average and salvage charges for which the insured is legally liable.” Usually, the insurance is based on the following warranty by the insured: “The insured’s occupation or business where the subject of this insurance is used in connection therewith, the description of the automobile insured, the facts with respect to the purchase of same, the uses to which it is and will be put, and the place where it is usually kept, as set forth and contained in this policy, are statements of facts known to and warranted by the insured to be true, and this policy is issued by the company relying upon the truth thereof.” In nearly all other respects the policy is similar to the standard fire policy. At times, however, valued policies are issued at an increased premium, the principle involved being similar to that discussed in connection with valued policies in marine insurance. (For sample copy of fire and transportation automobile policy see p. 451.)

Factors underlying the determination of rates.—Rates for fire and transportation coverage depend upon the use, construction and age of the car, its motive power, and the use of protective devices. Thus an examination of the

FIRE, TRANSPORTATION AND THEFT AUTOMOBILE RATES

(As published in the Automobile Insurance Manual for May 1, 1922.)

SCHEDULE "A"

(See Territorial Application appearing hereafter)

PRIVATE PASSENGER AUTOMOBILES

(Gasoline or Steam)

Age Groups	Class Symbols and Rates for Fire and Transportation Coverage							
	A	B	C	D	E	F	G	H
1	.40	.45	.55	.65	.75	1.00	1.25	1.50
2	.45	.55	.70	.85	1.15	1.50	1.75	2.00
3	.45	.70	.90	1.15	1.55	2.05	2.25	2.50
4	.65	.90	1.25	1.60	2.05	2.55	2.75	3.00
5	1.20	1.40	1.75	2.10	2.55	3.15	3.25	3.50

Age Groups	Class Symbols and Rates for Theft Coverage											
	L	M	N	O	P	Q	R	S	T	U	V	W
All	25	.35	.55	.75	1.00	1.50	2.00	2.50	3.25	4.00	5.85	6.85

COMMERCIAL AUTOMOBILES

(Gasoline or Steam)

Age Groups	Class Symbols and Rates for Fire and Transportation Coverage						Class Symbols and Rates for Theft Coverage			
	A	B	C	D	E	F	L	M	N	O
1	.75	.80	.90	1.00	1.15	1.25	.15	.30	.50	.75
2	.85	1.00	1.10	1.30	1.50	2.00	.15	.30	.50	.75
3	1.05	1.30	1.45	1.65	2.05	2.60	.15	.30	.50	.75
4	1.35	1.70	1.90	2.10	2.55	3.10	.15	.30	.50	.75
5	1.85	2.20	2.60	2.85	3.15	3.60	.15	.30	.50	.75

ELECTRIC AUTOMOBILES

(Private Passenger and Commercial Types)

Age Groups	Class Symbol and Rate for Fire and Transportation Coverage	Class Symbol and Rate for Theft Coverage
	X	Y
1	.50	.10
2	.75	.10
All Other	1.00	.10

schedule of rates on page 436 shows that private passenger automobiles, operated by gasoline or steam power, are divided into eight classes, the "class symbols" ranging from "A to H." Under each of these classes there is given the rate per \$100 of insurance, graded according to the age of the car. Rates, it will be observed, vary from a minimum of 40 cents (for a car of class A, age group 1) to \$3.50 (for a car of class H, age group 5).

The "class symbols" refer to the construction of the automobile from the standpoint of fire hazard. A system of credits is used to indicate the good features for the various makes of cars as determined by test at the laboratories of the underwriters. Thus a given number of points of credit is assigned to each of the following: storage of fuel, fuel feed, fuel line and fittings, carburetion, electrical equipment, exhaust system, and general workmanship. Further subdivision is then made of each of these main factors with a view to assigning to each subdivision a stated number of the total points of credit assigned to the main factor itself. The "storage of fuel," for example, is subdivided into tank capacity, location of the tank, construction of the tank, and mounting of the tank. The total number of points between the lowest of 400 for the poorest type of car and 5,200 for the best type is next divided into eight classes, represented by the class symbols, A to H, already referred to. Symbol H represents a car with only 400 to 1,000 points of credit, and the rate for a new car, as shown by the table on page 436 is \$1.50 per \$100 of insurance. For symbol A, representing the highest class of car, the points of credit range from 4,600 to 5,200, and the rate is only 40 cents. Using our previous illustrations, the fire and transportation rate on a new touring Ford (class symbol C, age group 1) is 55 cents per \$100 on a 1922 list price of \$443, or a premium of \$2.44; on a new five passenger touring Buick (class symbol D, age group 1) 65 cents on a

list price of \$1,395, or a premium of \$9.07; and on a new seven passenger touring Packard (class symbol A, age group 1) 40 cents on a list price of \$3,850, or a premium of \$15.40.

Special factors must be taken into account when rating commercial, livery and renting, and dealers' automobiles. The method of rating commercial automobiles is similar to that explained for private passenger cars, the class symbols ranging from A to F, and the rates for a new car from 75 cents to \$1.25. Livery and renting automobiles are divided into three classes. Class A comprises sightseeing automobiles, buses, taxicabs, jitneys and all automobiles of the private passenger type used entirely or occasionally for the carrying of passengers for compensation or lease (when operated and controlled by the owner or by a person regularly employed by him as chauffeur), and involves a charge of 1 per cent additional rate to the ordinary private type rate. Class "A2" comprises the same cars as noted under class A (but not operated or controlled by the owner or by a person regularly employed by him as chauffeur) and involves a charge of 2 per cent additional rate. Class B relates to hotel, club and school buses, undertakers' automobiles, etc., and involves no additional rate if the policy is subject to an endorsement that the automobile will be used only for the particular purpose. Dealers' automobiles are written under various forms of policies, some insuring an individual car, some covering all automobiles specifically insured, others insuring every automobile owned, and still others extending protection to all automobiles owned and irrespective of location.

Endorsements relating to protective devices, restrictions on the underwriter's liability, and additional coverage.

(1) An allowance of 15 per cent is granted from fire and transportation rates for the attachment of a "fire extinguisher endorsement," providing that "it is made a

condition of this insurance that the insured will at all times during the life of this policy carry on the automobile insured, in a readily accessible place, at least one fire extinguisher approved by Underwriters' Laboratories, Inc., and bearing their label; and that the insured will use due diligence to maintain the said fire extinguisher in full and complete working order during the life of this policy."

(2) Under the so-called "three-fourths value clause," the company's liability is limited to 75 per cent of the actual cash value of the property at the time of the loss or damage. When liability for loss is thus limited, rates are reduced from 10 to 20 per cent, depending upon the territory under consideration.

(3) Upon the payment of an additional premium the coverage may be extended to the following: Foreign coverage outside of the United States and Canada (the rate depending on the territory under consideration); tornado, cyclone or windstorm (involving additional rate of 20 cents); hail (additional rate of 10 to 15 cents depending on type of car); and earthquake, explosion and water damage (addition of 10 cents and the coverage may not be subdivided).

Theft Insurance.—*Definition of the coverage.*—This type of coverage is usually written in conjunction with the fire and transportation hazard, and is generally governed by the same general policy conditions. The protection offered extends to:

"Theft, robbery or pilferage, excepting by any person or persons in the Assured's household or in the Assured's service or employment, whether the theft, robbery or pilferage occur during the hours of such service or employment or not, and excepting also the wrongful conversion, embezzlement, or secretion by a mortgagor or vendee in possession under mortgage, conditional sale or lease agreement, and excepting in any case, other than in case of the

theft of the entire automobile described herein, the theft, robbery or pilferage of tools and repair equipment."

Factors underlying the determination of rates.—As indicated by the rate schedule on page 436, private passenger cars are divided into twelve classes, represented by class symbols L to W, on the basis of list price. Moreover, two territorial schedules, A and B, are used, the first involving the greater hazard and containing the higher rates. The rates, it should be added, are very high for the cheaper cars, and become smaller as the value increases, owing to the greater difficulty of stealing and disposing of a valuable car. Thus, it will be observed that the theft rate for private passenger cars under schedule A ranges from a minimum of 25 cents per \$100 of insurance under class symbol L to \$6.85 under symbol W. Material reduction in the rates may be obtained, however, by endorsing the policy with a three-fourths value clause, or a "restricted theft clause" excluding liability for theft of certain equipment, or both. Deductions of 15 per cent and 5 per cent are also allowed, respectively, for the use of (1) approved automobile locking devices and (2) approved spare tire locking devices.

Theft rates are surprisingly large in the case of low-priced cars. Loss of automobiles through theft has reached enormous proportions in recent years, and despite the high rates many companies have ceased writing this coverage on various makes of cars. Prior to the recent war most of the theft problem was confined to damage resulting from unauthorized joy-riding, and loss through theft for illegal sale and money gain was comparatively small. War conditions, however, completely changed the situation. Used cars doubled in value, and production of new cars decreased enormously. Moreover, there occurred a general moral breakdown, one manifestation of which is the extensive use of stolen cars in holdups, bank robberies and liquor run-

ning. All of these factors have contributed to make the theft rate on cheaper cars almost prohibitive. Referring again to our previous illustrations, the theft rate on a touring Ford (class symbol "W") is \$6.85 per \$100 of insurance on a 1922 list price of \$443, or a premium of \$30.40; on a new five passenger touring Buick (class symbol "U") \$4.00 on a list price of \$1,395, or a premium of \$55.80; and on a new seven passenger touring Packard (class symbol "M") 35 cents on a list price of \$3,850, or a premium of only \$13.48.

SPECIMEN OF AUTOMOBILE PUBLIC LIABILITY AND
PROPERTY DAMAGE POLICY

..... INSURANCE COMPANY

(Hereinafter called the Company)

HEREBY AGREES WITH THE ASSURED

Named in the Declarations attached hereto and hereby made a part hereof, as respects bodily injuries (or death resultant at any time therefrom) or property damage accidentally suffered or alleged to have been suffered by any person or persons during the term of this Policy, resulting from the ownership, maintenance or use, including loading or unloading, of any of the automobiles described in the Declarations, at any location within the United States of America or the Dominion of Canada, as follows:

To INDEMNIFY THE ASSURED against loss from the liability imposed by law upon the Assured for such bodily injuries or death so resulting;

To INDEMNIFY THE ASSURED against loss from the liability imposed by law upon the Assured for such damage or destruction of property of every description so resulting (excluding property of the Assured, or property of others used by or in charge of the Assured or of any of his employees or carried in or upon any of the Assured's automobiles), including loss of use of such property damaged or destroyed;

To DEFEND, in the name and on behalf of the Assured, all claims or suits for such injuries or damage for which the Assured is, or is alleged to be, liable;

To PAY all costs and expenses incurred with the Company's written consent;

To PAY all court costs taxed against the Assured in any such suit;

To PAY all interest accruing upon any judgment in any such suit;

To REPAY to the Assured the expense incurred in providing such immediate surgical relief as is imperative at the time of the accident.

THIS AGREEMENT IS SUBJECT TO THE FOLLOWING CONDITIONS:

ADDITIONAL ASSURED A. It is hereby understood and agreed that this Policy shall include as additional Assured any person, firm or corporation, not covered by other insurance against a claim hereunder, who is responsible for the operation of any automobile described in the Declarations and also any person or persons while riding in or legally operating any automobile with the permission of the named Assured or with the permission of an adult member of the Assured's household who is not a chauffeur or domestic servant, except as limited by endorsement attached hereto, provided that this Condition (A) of the Policy shall be null and void as respects any public automobile or any automobile manufacturer's or dealer's risk.

LIMITATION OF LIABILITY B. The liability of the Company under this Policy is limited as expressed in Item 6 of the Declarations, which limits shall apply to each automobile covered hereunder.

EXCLUSIONS C. This Policy shall not cover in respect of any automobile: (1) while driven or manipulated in any race or speed test; (2) while driven or manipulated by any person under the age fixed by law or under the age of sixteen years in any event; (3) while being used for towing or propelling any trailer or any vehicle used as a trailer. This Policy does not cover: (a) any liability of the Assured to any employee of the Assured while engaged in the maintenance or use of any automobile; (b) any liability voluntarily assumed by the Assured; (c) any liability imposed by any workmen's compensation law or agreement.

NOTICE AND SETTLEMENT D. In the event of accident, the Assured shall give prompt written notice thereof to the Company, or to one of its duly authorized Agents, and forward to the Company forthwith after receipt thereof every process, pleading or paper of any kind relating to any and all claims, suits or proceedings. The Assured, whenever requested, shall aid in securing information and evidence and the attendance of witnesses and in prosecuting appeals. The Assured shall make no settlement of any claim arising hereunder, nor incur any expense other than for immediate surgical relief, without the written consent of the

Company. The Company shall have the right to settle any claim or suit at its own cost at any time.

CANCELLATION E. This Policy may be canceled at any time at the request of the Assured, or by the Company, upon written notice to the other party, stating when thereafter cancellation shall become effective, and the date of cancellation shall then be the end of the Policy period. If such cancellation is at the Company's request, the earned premium shall be computed and adjusted pro rata. If such cancellation is at the Assured's request, the earned premium shall be computed and adjusted at short rates, in accordance with the table printed hereon. Notice of cancellation mailed to the address of the Assured as given herein shall be a sufficient notice, and the Company's check, similarly mailed, a sufficient tender of any unearned premium.

SPECIAL STATUTES F. If any of the terms or conditions of this Policy conflict with the law of any State in which coverage is granted, such conflicting terms or conditions shall be inoperative in such State in so far as they are in conflict with such law. Any specific statutory provision in force in any State in which coverage is granted shall supersede any condition of this Policy inconsistent therewith.

SUBROGATION G. The Company shall be subrogated in case of any payment under this Policy, to the extent of such payment, to all the Assured's rights of recovery therefor against any party or other entity.

ASSIGNMENT H. No assignment of interest under this Policy shall bind the Company unless its consent shall be endorsed hereon.

CHANGES I. No condition or provision of this Policy shall be waived or altered, except by endorsement attached hereto, signed by the President, a Vice-President, Secretary or an Assistant Secretary of the Company, nor shall knowledge possessed by any Agent or by any other person, be held to effect a waiver or change in any part of this contract. Changes in the written portions of the Declarations may be made by the Agent

countersigning this Policy, such changes binding the Company when initialed or signed by such Agent.

BANKRUPTCY J. In the event of the bankruptcy or insolvency of the Assured, the Company shall not be released from the payment of such indemnity hereunder as would have been payable but for such bankruptcy or insolvency. If, because of such bankruptcy or insolvency an execution against the Assured is returned unsatisfied in an action brought by the injured, or by another person claiming by, through or under the injured, then an action may be maintained by the injured, or by such other person against the Company under the terms of this Policy for the amount of the judgment in said action, not exceeding the amount of this Policy.

ACCEPTANCE K. The Assured by the acceptance of this Policy declares the several statements in the Declarations to be true, and this Policy is issued in consideration thereof and of the payment of the premium.

IN WITNESS WHEREOF, the COM-
PANY has caused this Policy to be
signed by its President and Secretary at
and countersigned by a duly authorized Agent of the Company.

.....
President.

.....
Secretary.

Countersigned;

.....
Agent.

AUTOMOBILE PUBLIC LIABILITY AND PROPERTY DAMAGE POLICY Attached to Policy No. . . .

..... COMPANY

Issued at

DECLARATIONS Old Policy No....

- ITEM 1.** The name of Assured is
- ITEM 2.** The address of Assured is
(Street, town or city and state)
- ITEM 3.** The Assured's occupation or business is
- ITEM 4.** The Policy period shall be months, beginning on the day of 192..., 12.01 A.M., and ending on the day of 192..., 12.01 A.M., standard time, at the place where the Policy has been countersigned.
- ITEM 5.** The automobiles covered by this Policy and the premium charges for same are as follows:

Trade Name	Factory Number	Style of Body	Model and Year Built	Mfrs. List Price Plus Cost of Additional Equipment	Date Purchased New or Second Hand	If Commercial Vehicle Load Capacity	Premium	
							Liability	Property Damage
							\$	\$
							Total Premium	\$

- ITEM 6.** The liability of the Company under this Policy is limited as follows:
- (a) ON ACCOUNT OF BODILY INJURIES to one person to the sum of.....Dollars (\$.....) and, subject to the same limit for each person, for any one

accident injuring more than one person, to the sum of.....Dollars (\$.....).

(b) ON ACCOUNT OF DAMAGE or destruction of property, to the actual value of the property damaged or destroyed at the time of damage or destruction or to the cost of its suitable repair or replacement, and to the actual money loss by reason of the loss of use of the property damaged or destroyed, and in any event to the sum of..... Dollars (\$.....) for any one accident resulting in such damage to or destruction of such property whether of one or more persons.

It is understood and agreed, however, that the limits of liability expressed above, shall not apply to the cost of defense of claims or suits, court costs, interest accruing upon any judgment or the cost of immediate surgical relief, as provided for herein.

- ITEM 7.** The automobiles covered hereby are and will be principally maintained and garaged in the city or town of
- ITEM 8.** The automobiles covered hereby are and will be principally used in the city or town (and its vicinity) of
- ITEM 9.** The automobiles covered hereby are and will be used only for the following purposes:.....
- ITEM 10.** None of the automobiles herein described are or will be rented to others or used to carry passengers for a consideration during the period of this Policy.
- ITEM 11.** No company has canceled or refused to issue any kind of automobile insurance for the Assured during the past three years, except as follows:

AUTOMOBILE COLLISION ENDORSEMENT

(Non-deductible)

IN CONSIDERATION of an additional premium of Dollars (\$.....), the Company hereby agrees with the Assured that if any automobile described herein, including its operating equipment while attached thereto, is injured or destroyed during the term hereof solely by accidental collision with another object, either moving or stationary, excluding injury or destruction by fire from any cause whatsoever, the Company will INDEMNIFY THE ASSURED against actual loss or damage by reason of such injury or destruction, not exceeding the actual cost of suitable repair or replacement or actual value at the time of the accident.

Injury to or destruction of tires due to puncture, cut, gash, blow-out or other ordinary tire trouble shall not be covered and injury to or destruction of tires shall not be covered in any event unless the loss or damage to such tire shall have been caused by an accidental collision which also causes other injury or destruction to the insured automobile.

In the event of disagreement, any loss, damage or repairs may be determined by two appraisers, one chosen by the Assured and one by the Company. The two appraisers, if unable to agree, may select a third. The award in writing of two appraisers shall determine the loss, damage or repairs. The Company and the Assured shall pay the appraiser respectively selected by each and shall bear equally the other expenses of the appraisal and of the third appraiser if one is selected. The Company may accomplish any repairs determined by the appraisers by such means as it may select, or, at the option of the Company, may replace the automobile (or its equipment) or pay in money the amount of the loss or damage determined by the appraisers.

The Company shall have reasonable time and opportunity to examine any injured automobile (or its equipment) before repairs are undertaken or physical evidence of the injury is removed, but the Assured shall not be prejudiced by any act on the Assured's part for the protection or salvage of the injured automobile (or its equipment).

Nothing herein contained shall vary, alter or extend any provision or condition of the Policy other than as above stated.

This endorsement becomes effective on the day of, 192....

Attached to and hereby made a part of.....Policy No.
of the

 issued to.....

Not valid unless countersigned by a duly authorized Agent of
 the Company.

Countersigned:

.....

Agent.

.....

Vice-President and General Manager.

COLLISION ENDORSEMENT

(\$50.00 Deductible)

In consideration of an additional premium of \$..... and subject to all conditions of this policy, the perils insured against hereunder are extended to include

ACCIDENTAL COLLISION

where the damage from such collision to the automobile and/or equipment herein described is in excess of \$50.00 each accident being deemed a separate claim and said sum to be deducted from the amount of each claim when determined; excepting:

(1) Loss or damage to any tire, due to puncture, cut, gash, blowout or other ordinary tire trouble; and excluding in any event loss or damage to any tire, unless caused in an accidental collision which also causes other loss or damage to the insured automobile;

(2) Loss or damage occurring while the automobile insured is engaged in any race or speed contest or while being operated by any person under the age limit fixed by law or in any event under the age of sixteen years.

In the event of loss or damage to said automobile, whether such loss or damage is covered by this endorsement or not, the liability of this Company against accidental collision under this endorsement shall be reduced by the amount of such loss or damage until repairs have been completed, but shall then attach for the full amount as originally written, without additional premium.

The amount recoverable for accidental collision under this endorsement shall not exceed the actual cash value of the property, (less a deduction of \$50.00 as above provided) at the time of any loss or damage, but shall not be limited by the amount of insurance named in the policy to which this endorsement is attached.

Attached to and forming part of Policy No....., of the
.....

Dated....., 19... Agency at.....
.....Agents

FIRE, THEFT AND TRANSPORTATION FORM

AUTOMOBILE POLICY

No.

THE COMPANY

IN CONSIDERATION OF THE PREMIUM HEREINAFTER MENTIONED
DOES INSURE

The Assured named herein, and legal representatives, for the term herein specified, to an amount not exceeding the amount of insurance herein specified, against direct loss or damage, from the perils insured against, to the body, machinery and equipment of the automobile described herein while within the limits of the United States (exclusive of Alaska, the Hawaiian Islands and Porto Rico) and Canada, including while in building, on road, on railroad car, or other conveyance, ferry or inland steamer, or coastwise steamer between ports within said limits. The following are the perils insured against:

- (a) *Fire*, arising from any cause whatsoever; and lightning;
- PERILS (b) *While being transported* in any conveyance by land
INSURED or water, the stranding, sinking, collision, burning
AGAINST or derailment of such conveyance, including general
average and salvage charges for which the
Assured is legally liable.
- (c) *Theft, robbery or pilferage*, excepting by any person or persons in the Assured's household or in the Assured's service or employment, whether the theft, robbery or pilferage occur during the hours of such service or employment or not, and excepting also the wrongful conversion, embezzlement, or secretion by a mortgagor or vendee in possession under mortgage, conditional sale or lease agreement, and excepting in any case, other than in case of the theft of the entire automobile described herein, the theft, robbery or pilferage of tools and repair equipment.

Amount \$..... Rate..... Premium \$.....

Name of Assured.....

Address of the Assured.....

No. Street City State

The term of this policy begins at noon on the.....day of
....., 19..., and ends at noon on the.....
day of.....19...

Amount of insurance.....Dollars (\$.....).

WARRANTIES

1. Assured's occupation or business is
2. The following is the description of the automobile:

Year	Model	Trade Name	Type of Body (If truck, state tonnage)	Factory or Serial No.	Motor No.	Advertised Horse Power	No. of Cylinders	List Price

3. The facts with respect to the purchase of automobile described are as follows:

Purchased by the Assured			Actual Cost to Assured Including Equipment	The Automobile described is fully paid for by the Assured and is not mortgaged or otherwise Encumbered, except as follows:
Month	Year	New or Second Hand		

4. The uses to which the automobile described is and will be put are:

5. The automobile described is usually kept in.....
.....garage, located
(State whether private or public)

.....
No. Street City State

Countersigned at.....this.....day of
.....19....

.....Agent

WARRANTIES The Assured's occupation or business where the
BY THE subject of this insurance is used in connection there-
ASSURED with, the description of the automobile insured, the
 facts with respect to the purchase of same, the uses
 to which it is and will be put, and the place where it is usually
 kept, as set forth and contained in this policy, are statements of

IMPORTANT: Be sure the facts stated in Warranties 1 to 5 are correct.

facts known to and warranted by the Assured to be true, and this policy is issued by the Company relying upon the truth thereof.

PROPERTY This Company shall not be liable for:

EXCLUDED (a) Loss or damage to robes, wearing apparel, personal effects, or extra bodies;

WAR, RIOT, ETC. (b) Loss or damage caused directly or indirectly by invasion, insurrection, riot, civil war or commotion, military, naval or usurped power, or by order of any civil authority.

OTHER INSURANCE No recovery shall be had under this policy, if at the time a loss occurs there be any other insurance covering such loss, which would attach if this insurance had not been effected.

CANCELLATION This policy shall be canceled at any time at the request of the Assured, in which case the Company shall, upon demand and surrender of this policy, refund the excess of paid premium above the customary short rate premium for the expired term. This policy may be canceled at any time by the Company by giving to the Assured a five (5) days' written notice of cancellation with or without tender of the excess of paid premium above the pro rata premium for the expired term, which excess if not tendered shall be refunded on demand. Notice of cancellation shall state that said excess premium (if not tendered) will be refunded on demand. Notice of cancellation mailed to the address of the Assured stated in the policy shall be a sufficient notice.

LIMITATION OF LIABILITY AND METHOD OF DETERMINING SAME This Company shall not be liable beyond the actual cash value of the property at the time any loss or damage occurs, and the loss or damage shall be ascertained or estimated accordingly, with proper deduction for depreciation however caused (and without compensation for the loss of use of the property), and shall in no event exceed what it would then cost to repair or replace the automobile or such parts thereof as may be damaged with other of like kind and quality; such ascertainment or estimate shall be made by the Assured and this Company, or if they differ, then by appraisal as hereinafter provided.

ABANDONMENT It shall be optional with this Company to take all or any part of the property at the appraised value where appraisal is had as hereinafter provided, but there can be no abandonment thereof to this Company; and where theft is insured against the Company shall have the right to return a stolen automobile or other property with compensation for physical damage, at any time before actual payment hereunder.

LOSS FOR WHICH BAILEE FOR HIRE IS LIABLE This Company shall not be liable for loss or damage to any property insured hereunder while in the possession of a bailee for hire under a contract, stipulation or assignment whereby the benefit of this insurance is sought to be made available to such bailee.

Where loss or damage occurs for which a bailee may be liable and which would otherwise be covered hereunder, this Company will advance to the Assured by way of loan the money equivalent of such loss or damage, which loan shall in no circumstances affect the question of the Company's liability hereunder and shall be repaid to the extent of the net amount collected by or for account of the Assured from the bailee after deducting cost and expense of collection.

NOON The word "Noon" herein means noon of standard time at the place the contract was made.

MISREPRESENTATION AND FRAUD This entire policy shall be void if the Assured has concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof; or in case of any fraud, attempted fraud, or false swearing by the Assured touching any matter relating to this insurance or the subject thereof, whether before or after a loss.

This entire policy shall be void unless otherwise provided by agreement in writing added hereto;

TITLE AND OWNERSHIP (a) If the interest of the Assured in the subject of this insurance be other than unconditional and sole ownership; or in case of transfer or termination of the interest of the Assured other than by death of the Assured or in case of any change in the nature of the insurable interest of the Assured in the property described herein either by sale or otherwise; or

(b) If this policy or any part thereof shall be assigned before loss.

ENCUMBRANCE Unless otherwise provided by agreement in writing added hereto, this Company shall not be liable for loss or damage to any property insured hereunder.

(a) While encumbered by any lien or mortgage.

LIMITATION OF USE (b) While the automobile described herein is frequently or habitually used as a public or livery conveyance for carrying passengers for compensation, and for one week after the termination of said use; or while being rented under contract or leased, or operated in any race or speed contest.

PROTECTION OF SALVAGE In the event of loss or damage occasioned by a peril insured against herein the Assured shall protect the property from further loss or damage and any such further loss or damage occurring directly or indirectly from a failure to protect shall not be recoverable under this policy. Any such act of the Assured or this Company or its agents in recovering, saving and preserving the property described herein, shall be considered as done for the benefit of all concerned and without prejudice to the rights of either party, and all reasonable expenses thus incurred shall constitute a claim under this policy; provided, however, that this Company shall not be responsible for the payment of a reward offered for the recovery of the insured property unless authorized by the Company.

NOTICE AND PROOF OF LOSS In the event of loss or damage the Assured shall give forthwith notice thereof in writing to this Company; and within sixty (60) days after such loss, unless such time is extended in writing by this Company, shall render a statement to this Company signed and sworn to by the Assured, stating the place, time and cause of the loss or damage, the interest of the Assured and of all others in the property, the sound value thereof and the amount of loss or damage thereon, all encumbrances thereon, and all other insurance whether valid or not covering said property; and the Assured, as often as required, shall exhibit to any person designated by this Company all that remains of the property insured and submit to examinations under oath by any person named by this Company, and subscribe the same; and as often as required, shall produce for examination all books of account, bills, invoices, and other vouchers, or certified copies thereof if originals be lost, at such reasonable place as may be designated by this Company or its representative, and shall permit extracts and copies thereof to be made.

Policy Conditions Continued Below

PASTE ENDORSEMENTS HERE

APPRAISAL In case the Assured and this Company shall fail to agree as to the amount of loss or damage, each shall, on the written demand of either, select a competent and disinterested appraiser. The appraisers shall first select a competent and disinterested umpire; and failing for fifteen (15) days to agree upon such umpire then, on request of the Assured or this Company, such umpire shall be selected by a judge of a court of record in the County and State in which the property insured was located at time of loss. The appraisers shall then appraise the loss and damage stating separately sound value and loss or damage to each item; and failing to agree, shall submit their differences only, to the umpire. An award in writing, so itemized, of any two when filed with this Company shall determine the amount of sound value and loss or damage. Each appraiser shall be paid by the party selecting him and the expenses of appraisal and umpire shall be paid by the parties equally.

PAYMENT OF LOSS This Company shall not be held to have waived any provision or condition of this policy or any forfeiture thereof by any requirement, act, or proceeding on its part relating to the appraisal, or to any examination herein provided for; and the loss shall in no event become payable until sixty (60) days after the notice, ascertainment, estimate and verified proof of loss herein required have been received by this Company, and if appraisal is demanded, then, not until sixty (60) days after an award has been made by the appraisers.

SUB-ROGATION This Company may require from the Assured an assignment of all right of recovery against any party for loss or damage to the extent that payment therefor is made by this Company.

SUIT No suit or action on this policy or for the recovery
AGAINST of any claim hereunder shall be sustainable in any
COMPANY court of law or equity unless the Assured shall have
fully complied with all the foregoing requirements,
nor unless commenced within twelve (12) months next after the
happening of the loss; provided that where such limitation of
time is prohibited by the laws of the State wherein this policy is
issued, then and in that event no suit or action under this policy
shall be sustainable unless commenced within the shortest limita-
tion permitted under the laws of such State.

This policy is made and accepted subject to the provisions, exclusions, conditions and warranties set forth herein or endorsed hereon, and upon acceptance of this policy the Assured agrees that its terms embody all agreements then existing between himself and the Company or any of its agents relating to the insurance described herein, and no officer, agent or other representative of this Company shall have power to waive any of the terms of this policy unless such waiver be written upon or attached hereto; nor shall any privilege or permission affecting the insurance under this policy exist or be claimed by the Assured unless so written or attached.

In witness whereof, this Company has executed and attested these presents; but this policy shall not be valid unless counter-signed by a duly authorized Agent of the Company.

.....
Secretary

.....
President

CHAPTER XXIX

CORPORATE BONDING

Definition and General Nature.—A surety bond has been defined as a “written obligation, usually given under seal, to pay a sum of money under one or more expressed conditions, among which may be found negligence, breach of trust, disobedience of a law, failure to pay a judgment, failure to pay a debt voluntarily assumed, and other conditions under which losses may be sustained by personal acts.”¹ The surety is the party who “is responsible for the debt, obligation or conduct of another,”² and in corporate suretyship is a corporation. Broadly speaking, risks written by bonding companies are of three kinds, namely, fidelity bonds, contract bonds, and court bonds. This division has been recognized by the Insurance Law of New York, which defines suretyship as follows: (1) “guaranteeing the fidelity of persons holding positions of public or private trust”; (2) “guaranteeing the performance of contracts other than insurance policies”; and (3) “executing or guaranteeing bonds or obligations in actions or proceedings or by law allowed.”

Although classed and supervised as insurance under the law, corporate bonding presents certain important features not usually associated with insurance. In the first place suretyship involves relations between three parties, namely, (1) the “surety,” giving the guarantee and

¹ R. R. Brown, First Vice-President of the American Surety Company of New York, in a lecture at Princeton University.

² W. A. Thompson, Vice-President of the National Surety Company, in a lecture at Columbia University.

corresponding to the insurer; (2) the "obligee," receiving the protection and corresponding to the insured; and (3) the "principal" or "obligor" for whose debt, obligation or conduct the surety assumes responsibility. Nearly all classes of insurance permit cancellation of the contract, but this cannot be done by the surety company and its customer—the principal on the bond—unless the obligee, who possesses legal rights in the bond and for whose protection the bond was issued, gives his consent. In fact, certain bonds, owing to statute provisions, are rendered altogether noncancellable. Except in a limited number of cases where the right of subrogation against negligent parties exists, insurance companies pay losses without the right of reimbursement. Upon payment of a loss to the obligee, however, bonding companies are entitled to full reimbursement from the principal, although in practice this right often proves of little advantage.

The Folly of Personal Suretyship to the Bondsman.—References to the practice of bonding date back to very ancient times, but until recently the bonds were signed by individuals, usually without compensation and as a matter of friendly accommodation. The Book of Proverbs makes frequent reference to personal suretyship, and always in a warning sense. Thus in Proverbs 6:1: "If thou be surety for thy friend, if thou hast stricken thy hand with a stranger, thou art snared with the words of thy mouth"; Proverbs 11:15: "He that is surety for a stranger shall smart for it; and he that hateth suretyship is sure"; Proverbs 17:18: "A man void of understanding striketh hands, and becometh surety in the presence of his friend"; and Proverbs 22:26: "Be not thou one of them that strike hands or of them that are sureties for debts. If thou hast nothing to pay, why should he take away thy bed from under thee?"

The truth of these admonitions cannot be emphasized too strongly. Too often the bondsman, when signing a bond for a friend, assumes that he is only guaranteeing that friend's honesty, whereas the obligation may extend to the proper performance of duties and thus also involves the hazards of carelessness, neglect, ignorance of the law or other incapacity, or lack of financial strength. But even where character is the only factor involved, it is well to bear in mind, as has been said, that: "Honesty, like time-tables, is subject to change without notice. Men who have been faithful for years suddenly yield to temptation and fall, and the bondsman is called upon to make good the loss—perhaps at great sacrifice." When signing a bond, the bondsman impairs his financial credit by assuming a hazardous contingent liability. Perhaps the greatest drawback of personal suretyship is its lack of supervision over the conduct of the person bonded. It does seem strange indeed that individuals should assume such risk without the thought of compensation. One writer makes the interesting comment that: "There is no other branch of insurance where an incorporated company must compete with an individual for a certain piece of business, the company charging a proper and adequate fee for its service and handling the matter on a business basis, and the personal surety performing the service without the hope of fee or reward."³

Advantages of Corporate Suretyship to the Principal and Obligee.—Not only does corporate bonding relieve individuals, who are reluctant to impair their financial credit with a contingent liability, of the unpleasant task of declining to accommodate friends or relatives, but it extends to both principal and obligee numerous benefits

³ Ernst A. Robbin in lecture on "Fidelity and Surety Insurance" before the "Dallas School of Commerce."

that cannot possibly be secured through personal suretyship. In fact, with corporate surety bonds available at comparatively small annual premiums, it is unfair and most unbusinesslike for any one requiring a bond to ask a friend to encumber his property and jeopardize his estate by way of a gratuitous accommodation. As one writer puts it: "Where is the man who would think of asking his neighbor or friend to insure him against financial loss by reason of fire, accident, health or death? The same principle should always apply to surety. Why should you ask your friends to insure your honesty, your judgment, your calculations, your finances or your chances of winning a law-suit."⁴

Reference should be made to the following nine benefits of corporate suretyship, the first four pertaining to the principal, the last three to the obligee, and the fifth and sixth to both of these parties:

(1) Persons requiring bonds are relieved of the necessity of requesting accommodation from their friends, thereby often placing themselves in a position where they are morally bound to reciprocate the favor when the opportunity offers.

(2) Public officials, bank and corporation officers, contractors, employees and other principals are freed from the likelihood of undue influence being exercised over them by those who accommodated them as sureties.

(3) Many persons of integrity are enabled to assume positions of trust, although they are without friends or property.

(4) Heirs and next of kin may become trustees, executors and administrators of the estates of their deceased relatives, although they might not otherwise be able to qualify as such. Management of the estate can

⁴ L. C. Reynolds in "Rough Notes," September, 1920, p. 17.

thus be assumed by those most interested in an economical and prompt settlement.

(5) The bonding company's supervisory control over the principal, and its severity in prosecuting wrong-doers, are an incentive to right-doing and have greatly reduced the number of embezzlers. The moral effect of a corporate bond, in other words, often proves the greatest protection against wrong-doing on the part of the bonded individual.

(6) The bonding company's supervisory control over the business methods of employers, named as obligees, serves as a safeguard against loss through dishonesty of employees.

(7) The obligee is enabled to know the responsibility of the security behind a corporate bond. The financial resources of individual sureties are changeable and difficult to estimate. Bonding companies, on the contrary, are strongly backed by large capital and surplus funds, regularly reported to and published by the State Insurance Departments.

(8) Bonding companies operate in accordance with law and are strictly supervised by the United States Government and the respective insurance departments of the several states. They are prohibited from issuing any one bond in excess of an amount equal to 10 per cent of their capital and surplus, unless the excess is secured by collateral or authorized reinsurance. Many states also prohibit the charging of different rates for the same class of bonds, while others require the filing of premium tariffs, thus tending to safeguard the business against unfair or unsound methods.

(9) Personal sureties, merely granting friendly accommodation without compensation, have frequently been the subject of favoritism by the law, their release from liability having been obtained on technicalities, such as a slight variation from the contract without consent. Such in-

dulgence has not been shown to bonding companies. Instead, the courts have applied to corporate bonds the same strict interpretations that they have enforced against other insurance policies. Moreover, bonding companies are in the bonding business for business purposes, and prompt and fair settlement of claims is recognized as essential to a good business reputation.

Development of Corporate Bonding.—Owing to the advantages of corporate suretyship, the personal bondsman is being rapidly displaced. The first company to write surety bonds in the United States was the Guarantee Company of North America, a Canadian corporation. This company began business in the United States in 1872, but limited its bonds to the officers of banks, railroads and corporations generally. The State of New York had passed an act in 1853 authorizing the incorporation of such companies, but it was not until 1876 that the Fidelity and Casualty Company of New York began writing business. It confined its bonding business at that time, however, to fidelity bonds. In 1884 the American Surety Company of New York was formed, and went a step further than the Guarantee Company of North America by guaranteeing bonds for court proceedings and for contractors and fiduciaries. Next, in 1890, the Fidelity and Deposit Company of Maryland was organized, which, in addition to issuing all the bonds of its predecessors, made a new departure in bonding public officials of all kinds, whether national, state, county, or municipal.

During the past twenty years the growth of corporate bonding has been remarkable. For the year 1919, the total premium income amounted to \$49,406,480, of which about one-third is assignable to the fidelity end of the business and two-thirds to the surety portion. Over a million bonds are written annually with an aggregate amount of liability in excess of five billion dollars. With respect to the com-

panies writing bonds for the United States Government, combined capital and surplus exceeds \$65,000,000, and aggregate resources total \$150,000,000.

Classification of Bonds.—Not only has corporate bonding attained large proportions financially, but it has constantly extended its field of usefulness by increasing the variety of bonds issued. At present the companies are said to issue upwards of eight hundred different kinds of bonds. Having in mind the nature of the obligation assumed, the following broad classification comprises virtually all of the leading kinds of corporate bonds:

Fidelity bonds, guaranteeing employers (individuals, firms, corporations, associations or institutions) against loss of money or property through the dishonesty, and in some cases the negligence, of their employees or officers. The various classes of employers differ, of course, with respect to the selection of employees, the conditions surrounding employment, and the hazard involved. Most companies, therefore, classify fidelity bonds under the following groups of employers:

Banks, trust companies and financial institutions.

Insurance companies.

Stock, grain and other brokers.

Public service corporations of all kinds.

Mercantile and manufacturing concerns.

Building and loan associations.

Fraternal and benevolent organizations.

Business associations.

Hotels and clubs.

Labor organizations.

Amusement enterprises of every description.

Miscellaneous.

Public official bonds, given by officials of the Federal Government and of state, county and municipal governments, who handle public funds or whose actions are apt

to affect public funds, and making the surety liable for losses resulting from breach of trust, and also frequently from negligence, ignorance of the law and errors of judgment. To meet special conditions, these bonds are usually subdivided under numerous groups, such as employees of the State Department, Treasury Department, the War and Navy Departments, Department of Justice, Post Office Department, Department of the Interior, Department of Commerce and Labor, tax collectors, state and municipal treasurers, sheriffs and deputy sheriffs, etc.

Contract Bonds, protecting the obligee against default on the part of contractors in carrying out the specifications and terms of any written contract. Such bonds guarantee the character, capacity and financial strength of the principal, and may assume any one of four forms, namely:

- (1) *Bid or proposal bonds* (guaranteeing that the bidder, if successful, will furnish a final bond guaranteeing fulfillment of the contract).
- (2) *Construction bonds* (guaranteeing fulfillment of contracts for construction work).
- (3) *Supply bonds* (guaranteeing the furnishing and delivery of supplies, materials, commodities, or machinery).
- (4) *Maintenance bonds* (guaranteeing that a designated piece of work or supplies furnished will endure for a stated period of time without the need of repairs).

Court bonds (judicial bonds), issued on behalf of fiduciaries or in connection with judicial proceedings. Three sub-divisions suggest themselves:

- (1) *Probate bonds* (given by administrators, executors, guardians, testamentary trustees, committees, and similar fiduciaries).

- (2) *Insolvency bonds* (given by receivers, assignees, and trustees in bankruptcy).
- (3) *Bonds required of litigants* (filed in court proceedings such as attachment, appeal, replevin, certiorari, costs, condemnation of land, garnishment, injunction, mandamus, right of way, stay of execution, stay of proceeding, bail or appearance in criminal proceedings, etc.).

Customs and internal revenue bonds, guaranteeing (1) that importers will pay any damage arising from their failure to comply with the customs laws and regulations, and (2) that internal revenue taxes will be paid and that there will be an observance of internal revenue laws and regulations with respect to the manufacturer, storage, transportation and sale of alcoholic beverages.

License, franchise and permit bonds, conditioned for the observance of the law relating to the particular occupation and the payment of any penalty in case of failure to do so, and required of the thousands of plumbers, employment agencies, pawnbrokers, auctioneers, saloon-keepers, electricians, draymen, custodians of explosives, ticket brokers, theaters, etc. Such bonds, as indicated, are of three classes, namely:

- (1) *License bonds* (applying where the business may be undertaken and discontinued at will).
- (2) *Franchise bonds* (applying where the business, once undertaken, must be continued).
- (3) *Permit bonds* (permitting the principal to do a particular act).

Depository bonds, given by banks and trust companies, in pursuance of statute or other requirement, guaranteeing the repayment (either promptly or following liquidation of the bank's affairs, depending on the nature of the bond)

of deposits in the event of the insolvency of the bank. Such bonds are mostly issued to protect state, county and municipal funds. But to an increasing extent, the deposits of insurance companies, fraternal orders, court clerks, etc., are also secured by this type of surety bond.

Miscellaneous group, comprising an immense variety of bonds, too numerous to be recounted. In some cases these bonds may resemble some of the previously defined groups so closely as to warrant their inclusion thereunder. The following may be mentioned as the most important:

- (1) *Common carrier bonds* (given by carriers and guaranteeing the safe custody and prompt transportation of dutiable merchandise).
- (2) *Admiralty bonds* (given by owners of vessels and cargoes in admiralty proceedings and conditioned for the payment of damages and claims to other vessel and cargo owners).
- (3) *Warehouse bonds* (guaranteeing the safe custody and re-delivery of the stored goods upon surrender of the warehouse receipt, thus making the receipt, especially in the case of fungible goods that are intermingled, readily saleable or available as collateral).
- (4) *Lost instrument bonds* (indemnifying the maker of the lost instrument—stock certificates, bonds, insurance policies, deeds, checks, etc., lost, stolen or apparently destroyed—against the consequences of the instrument reappearing in the possession of some other party, either innocent or not).
- (5) *Forgery bonds* (covering any loss sustained by the insured or obligee through (1) forgery of the signature or an endorsement on any check or draft drawn by the obligee, or (2) the felonious raising or altering of the amount payable under any check or draft drawn by the obligee).

- (6) *Bonds covering titles to real and personal property* (applying especially where property has certain liens against it or when infringement upon patent is alleged).
- (7) *Bonds guaranteeing protection of instruments or documents* (at a definite time under definite circumstances).

Factors Governing the Underwriting of Fidelity Bonds.

—*Considerations underlying the acceptance of the risk.*⁵—

Before accepting the risk under fidelity bonds, the underwriter must make careful inquiry concerning the character and record of the employee, the character and standing of the employer, and the conditions surrounding the employment. With respect to the employee, the bonding company will want to know the following (see application blank on page 476): What has been the applicant's record for integrity, as revealed by references, and his past business conduct? Does his past employment suggest fitness for the new position concerning which the bond is desired? What are the applicant's financial obligations as regards debts, and dependents for support? What compensation will he receive in his new position and what other sources of income does he possess? Will the entire income be sufficient to enable the applicant to meet his financial obligations? What have been his habits with respect to intoxicants, gambling, speculation, etc.? Who are his nearest relatives and what is their net worth?

⁵ Space limits forbid a detailed explanation of the policy conditions and the factors that govern the acceptance of the risk with respect to each of the numerous types of bonds. This would require a volume in itself. As indicating the fundamental nature of corporate bonding, our explanation is, therefore, limited to a summary of the important factors considered by underwriters when writing fidelity, contract, court, and depository bonds. For a detailed consideration of practically all types of bonds the reader is referred to Mr. H. G. Penniman's "Manual of Fidelity Insurance and Corporate Suretyship."

Having satisfied himself as to the employee's character and past record, the underwriter must next make sure of the employer's character and standing. The so-called "Employer's Statement" (see page 481) is designed to acquaint the bonding company with the following: Is the employer engaged in a legitimate business? Is his reputation good or is he likely to present temptation to the employee or to make improper claims himself? Is he constantly changing his employees, and is he inclined to resort to litigation? When were the accounts of the employer last audited and what was the result? What method of financial control is exercised over employees and at what intervals is there an audit? What is the exact nature of the employee's duties and what powers will be given him? The underwriter will also desire to know the following: Is there such a division of labor in the business as to cause any dishonesty of the principal to be promptly discovered by other employees? Is the accounting system designed to impose effective checks? Is the business likely to bring the employee into close contact with persons disposed to be extravagant or to conduct themselves improperly?

Factors to be considered when a claim arises.—In the event of a loss, the bonding company must determine (1) whether the employer possesses a valid claim against the employee; (2) does the claim, if valid, come under the terms of the bond; and (3) can the employee be induced to relieve the company by making a proper settlement with his employer. Care must be exercised to see that the employer does not charge the employee with responsibility for losses which should really attach to the business; also that he has observed his promises under the bond with respect to notice of loss, proof of claim, etc.

Salvages.—After the settlement of a claim, the bonding company is entitled, and this applies to all kinds of bonds,

to full reimbursement by the principal. While the company will insist upon prosecution in the absence of such reimbursement, it does not feel that it has any right to interfere between employer and employee, if the latter will settle in full, or his relatives or friends will do so for him. The importance of such salvage is indicated by the experience of one large company, whose recovery by way of reimbursement from principals has approximated 40 per cent of all its paid claims on fidelity bonds.

Punishment of defaulters.—Assuming that a defaulter does not make restitution, the surety company's policy is to follow him without cessation until he either settles in full or is made to suffer the fullest penalty of the law. As has been said, "defaulters should be impressed with the fact that a surety company lives long and never forgets." This feature of the bonding business produces a moral effect that has proved a powerful deterrent against wrong-doing.

Types of policies and leading policy conditions.—Fidelity bonds are of three general types, namely, (1) the individual form (for copy see page 485), covering an individual filling a particular position; (2) the schedule form (for copy see page 488), covering "any of the employees named in the schedule attached to the bond not exceeding the amount specified in said schedule for such employee"; and (3) the blanket form, now little used, covering any and all employees to the full amount of the bond. In the customary fidelity bond the company agrees to reimburse the employer for any loss of money or other personal property, not exceeding a certain specified sum, which may be sustained by reason of fraud, dishonesty, forgery, theft, embezzlement or wrongful abstraction of the employee. The bond usually provides that the embezzlement must have been committed during the term of the bond, or

any renewal thereof; and that the right to make a claim must be made before the end of six months after the termination, expiration or cancellation of the bond. The employer agrees to give immediate notice to the company of the discovery of any dishonesty on the part of the bonded employee, and to furnish full particulars within a given time. He also agrees to furnish the company with every aid and assistance possible, not pecuniary, which will help in bringing the wrongdoer to justice. In case more than one bond covers the individual in question, the company will pay the loss only in the proportion that its bond bears to the total sum of all the bonds, whether these are available or not.

Factors Governing the Writing of Contract Bonds.—

Such bonds guarantee the honesty, ability and financial strength of contractors, and represent one of the most hazardous branches of the surety business. Before accepting the risk, the underwriter will want to be fully informed concerning the following, and to this end a most voluminous and detailed application blank is used:

(1) The character, ability, and financial capacity of the contractor. The surety company must be sufficiently certain of the contractor's ability and financial standing to be willing to lend its own credit to the enterprise. To this end it will make careful inquiry into his previous experience and fitness for the work contemplated, his financial standing and quick assets as compared with all his uncompleted contracts, the amount of life, compensation, liability and builders' risk insurance he carries, and the amount of contingent liability he may have assumed by way of endorsement for others.

(2) The nature of the work, involving a careful examination of the contract, as well as its advisability from the standpoint of the contractor's experience.

(3) The form of the contract, since it is usually pre-

pared by some one in the employ of the obligee, and therefore, usually in his favor. It is important that the contractor's rights be protected, and especially, that there be proper provision for payments as the work progresses.

(4) The contract price, with a view to seeing that it is sufficiently high to meet the situation or to net a reasonable profit to the contractor.

(5) The character of the obligee and his engineer or architect, with a view to avoiding those who have a reputation for being litigious or unreasonable.

Contractors are also required to enter into an indemnity agreement with the surety company, providing among other things, that they will furnish the company with legal evidence of the completion of the work or release under the bond; will reimburse it for any loss or expense it may sustain under the bond; and will give it possession of the contractor's plant, and subrogate it to all rights under the contract, in case of failure to complete the work.*

Factors Governing the Underwriting of Court Bonds.—Such bonds, as previously stated, guarantee the honesty and ability of fiduciaries, or are given in judicial proceedings. They must usually be issued promptly, and are noncancellable. Bonds to fiduciaries are of two main classes, namely, (1) where the principal is charged only with the prompt distribution of an estate; and (2) where he takes possession of the property, supervises the investments, and pays the income to the proper parties. The first type is by far the least hazardous and usually runs for comparatively short periods only. The second involves considerable risk and often extends over long periods of time. Before accepting the first group, the

* (For a statement of the obligations of surety and obligee, see copy of contractor's bond on page 490.)

surety company will want to know, among other things, the names of the attorneys advising the principal, the name of the institutions where the principal deposits the money and securities of the estate, whether the principal is indebted to the estate and how the debt is secured, the amount of property, real and personal, owned by the principal, and the assets and liabilities of the estate. The principal is also required to enter into an indemnity agreement, whereby he promises to furnish the company with copies of all important papers such as inventory, accounts, etc.; to deposit cash and securities belonging to the estate in certain designated institutions with permission to the company to examine them at all reasonable times; to secure a court order before converting any assets of the estate into cash; to withdraw money from bank only by check signed in his fiduciary capacity; to keep true and accurate papers and books of account, open to the company's inspection at all times; and to furnish the company with complete evidence of the termination of the trust.⁷

Claims under fiduciary bonds do not arise usually until after there has been an accounting, and the claim must be paid promptly when fixed. Frequently the claim is the result of an error, and not of a crime. Moreover, reimbursement by way of salvage is not nearly so large as in the case of fidelity bonds. Should the default, however, be criminal in character the company will pursue the same drastic methods with respect to the defaulter, as already noted in connection with fidelity bonds. With respect to bonds required by litigants, many are especially hazardous, like those relating to appeal, bail in criminal proceedings, discharge or release of attachment, indemnity to sheriff, stay of execution, etc., and are only

⁷ For a detailed account of the factors underlying the acceptance of court bonds, see Penniman's "Manual of Fidelity Insurance and Corporate Suretyship," p. 89.

executed when cash collateral or its equivalent is furnished by the principal.

Factors Governing the Underwriting of Depository Bonds.—These bonds are of either the “prompt payment” or the “deferred payment” class. The first, required by the Federal, State, and local Governments, are by far the most hazardous since they involve immediate payment. Bank failures are most likely to occur at times when the security investments of a bonding company are selling at greatly depreciated prices, with the result that the company, in selling its securities to meet an immediate claim under a prompt payment bond, will suffer a substantial loss in addition to that involved in the failure itself. In writing such bonds the company must be careful to take into account the type and standing of the bank. It will also attempt to spread its risks territorially, and to avoid protecting an undue amount of deposits in banks that are closely allied and which may thus be adversely effected by a failure of one of their number.*

The Premium.—In arriving at the premium on a bond, the company must be careful to ascertain the extent of its actual liability. It may be that the company assumes a smaller actual liability by bonding a state treasurer, who in the course of a year may have millions of dollars under his guardianship and who may be required by law to furnish a bond for \$500,000, than by bonding the cashier of a bank, although its liability in this case may be limited to \$25,000. Surety rates are fixed on three bases, namely, on (1) per unit of exposure, (2) per unit of the penalty of the bond, or (3) the price involved in

*For a detailed account of both types of depository bonds see Penniman's "Manual of Fidelity Insurance and Corporate Suretyship."

the contract. But where the premium is computed on the last two bases, the regular rate per thousand will differ greatly according to the hazard involved, varying all the way from one to twenty dollars and even more. Doubtful or sub-standard risks are assumed at times at greatly increased rates. To a large extent, especially on bonds where the company is well protected by collateral and where the loss ratio is small, surety rates represent payment for service (as distinguished from the assumption of risk), such as the work of investigation preceding the acceptance of the risk.

SPECIMEN COPY OF EMPLOYEE'S APPLICATION BLANK

....., *New York City.*

FORM To be com- pleted by Agent	{	Agency.....	Rec'd N. Y.....
		Effective Date.....	
		Amount.....	
		Premium.....per annum.	File No.....

EMPLOYEE'S STATEMENT.

To the.....COMPANY, New York City.

The undersigned hereby agrees that you may indemnify the Employer hereinafter named in any amount the Employer may desire in favor of.....(Employer) to such extent and in such form as may be agreed upon between you and the Employer in respect of the acts of the undersigned in said Employer's service as.....at.....in the State of.....or in any other position in the Employer's service to which the undersigned may be appointed, and hereby affirms that the following answers are the truth without reservation, and that they are made to induce the.....Company to indemnify the said Employer as herein above mentioned.

EMPLOYEE WILL ANSWER ALL QUESTIONS IN FULL

1. What is your full name? (Christian and middle names, in *full*).....
2. *Post-Office Address?* (Street and Number.....)
3. Give age.....place and date of birth. Place:.....
Date: Month.....Day.....Year.....
4. (a) What nationality are you?.....
(b) If not born in the United States, how long have you lived in the United States?.....
(c) If a foreigner, have you been naturalized?
5. Married, single, or widower?.....Wife's Name.....
.....Number of Children.....
6. If others are dependent on you for support, wholly or in part, give names, relationship and other details.....
.....

7. How long have you resided in present locality?.....
 Previously where?..... How long?.....
8. Do you own or rent the house in which you live, or do you board?.....
9. What is the nature of this Employer's business?.....
10. How long have you been in the service of this Employer?.....
 In what Positions?.....
11. What are your duties in this position?.....
 What experience have you had relative to the duties and accounts of this position?.....
12. What salary will you receive?.....
 If any other allowance will be made you or if salary is subject to any deduction, state particulars.....
13. Below state how you have been occupied during past *ten* years, *whether employed or not.* Closely following headlines.

FROM		TO		In the Service of	As	At	Under	Why Did You Leave?
Month	Year	Month	Year	(Name of Employer or Corporation)	(Nature of Position or Occupation)	(Place where Employed or located)	(Name and Present Address of Manager or Supt.)	
.....	1.....	.....	1.....	(Space provided for the record extending over	12 years			

14. REFERENCES. *Do not name a relative, former employer, or any one in the service of this employer.*

NAME	OCCUPATION	POST OFFICE ADDRESS (Number and Street, if in City)
1.....		
2..... (Space provided for five references)		

15 RELATIVES	Name	Occupation	Address	Net Worth
Father	{ If not living, other nearest relatives }	.....	.....	.....
Mother		.....	.....	.....
Brother		.....	.....	.....
..	
Sister		.....	.....	.....
Wife's Father		.....	.....	.....
.. Mother		.....	.....	.....

16. To what extent do you use intoxicants?
17. Give names of any club, lodge, society, association, fraternal or
beneficial organization of which you are a member or officer
.....
18. Have you ever been discharged from any position? If so, give
particulars.
19. Have you ever been in arrears or default in your present or
any previous employment? If so, give full particulars
20. Do you owe your Employer anything? If so, state how much,
on what account, and when due.
21. Do you own real estate in your own name? If so, state following
particulars: Location.....
Value \$. Mortgage \$. Give name
and address of Mortgagee..... Description
.....
22. Give description and approximate value of your personal
property whether household goods, cash on hand or in bank,
or anything of value.
23. Are you interested or engaged in any other business?.....
Give location, description, name of firm or partners and
income derived therefrom.....
24. Have you ever become insolvent or failed in business?.....
When?..... Liabilities?.....
Names and addresses of creditors.....
25. Have you ever compromised or compounded with creditors?
..... When and upon what terms?.....
Names and addresses of creditors.....
26. Have you any debts besides mortgages?..... Amount?
..... When due?..... How
incurred?..... *Names and addresses of creditors*.....
27. State whether you are endorser or surety for any one, and to
what extent?.....
28. Have you ever speculated in Stocks, Grain, Oil, Real Estate,
dealt in options, played cards for money, or gambled in any
way?.....
29. Do you carry life insurance? If so, how much, in what com-
pany, and to whom payable?.....

30. Have you ever had a bond canceled, or an application declined by any Surety Company?.....If so, *when, where, and by what company?*.....
31. Have you ever been asked or required to give a bond or anything else in the form of security to any Surety Company?.....
32. If you have ever given bond, state particulars in following space:

Name of Surety	Address	Date	Why Terminated
----------------	---------	------	----------------

For good and valuable considerations, the undersigned hereby agrees to indemnify and save harmless the said..... Company from and against any and all loss, damage, fees, or expense which it may incur or sustain by reason of having agreed to indemnify as hereinabove set forth against the acts or omissions of the undersigned in the positions mentioned and referred to, or in any other position that may be filled by him, and to make good and reimburse to the Company all sums of money which it may pay or become liable to pay in consequence of any such agreement of indemnity. The undersigned also agrees that the Company may at any or all times decline to assume indemnity in his behalf in any position whatsoever, and may at any time terminate such indemnity assumed in his behalf in connection with any position whatsoever, and expressly releases the Company from furnishing reasons for terminating its indemnity aforesaid, and from any and all claims, demands, damages or causes of action that may accrue by reason of the failure of the Company to furnish such reasons. The undersigned also agrees that the Company, or any present or former employer of the undersigned, or any other person, firm or corporation, may disclose and furnish any information which they may have obtained or may at any time obtain concerning the undersigned or his affairs, and the undersigned hereby expressly releases and discharges the Company and each and all of the said employers, persons, firms or corporations from any and all claims, demands, damages or causes of action arising by reason of the furnishing or disclosing of such information whether the same be true or not. The undersigned also hereby agrees that the vouchers or other proper evidence showing payment by the Company of any claim, demand, loss, damage, fees, or expenses in connection with any such indemnity in his behalf shall be conclusive evidence of the

fact and amount of liability in that respect of the undersigned to the Company, provided that such payment shall have been made by the Company in good faith, believing it was liable therefor.

In witness whereof, the undersigned has hereunto subscribed his name and affixed his seal this day of, 19..

Signed, Sealed and delivered in the presence of [SEAL]

.....
Witness.

.....
Signature of Employee.

EMPLOYER'S DECLARATION

The foregoing employee has been in the service of the undersigned Employer.....years and.....months and the duties required have always been performed in a faithful and satisfactory manner. The accounts were last audited on the.....day of, 19.., and were correct in every particular. There has never come to the notice or knowledge of the Employer any act, fact or information tending to indicate that Employee is negligent, unreliable, deceitful, dishonest or unworthy of confidence. As far as the Employer knows, Employee's habits are good.

Dated at.....the.....
day of.....19....

.....
(Employer)

By.....
(Officer's name and title if Corporation)

PERSONAL DESCRIPTION.

Weight.....Height.....Color.....
Color of Eyes.....Color of Hair.....Complexion.....
Peculiar Marks.....

.....
Signed.....

SPECIMEN COPY OF "EMPLOYER'S STATEMENT"

THE.....COMPANY

This "Employer's Statement" is designed to show the bonding Company the general accounting and auditing conditions of the positions bonded. Ordinarily one of these forms is to be completed by the employer for each official or employee bonded; but if two or more employees hold the same position, so that a single form will serve the purpose for both or all, only one form need be completed for such employees. In some cases not all the questions submitted will be appropriate: a statement to that effect may then be made.

-
1. Name of person bonded, hereinafter
called the Employee, and position held:

(If the form is intended to cover two or more persons holding the same position—a number of branch-office managers, for example—write here, "All persons bonded holding the position of.....").

- a. If only recently employed, how did the Employee become known to you? a.
2. b. If employed some time ago, has the Employee uniformly given satisfaction in his personal conduct and performance of duties, and kept his accounts faithfully and without default? b.
-

- a. At what date and by whom was the Employee's office last audited? a. On....by.....
3. b. Were the accounts found correct, and were the funds on hand sufficient in amount? b.
- c. Did the audit include a verification of receivables, and of all moneys reported as on hand and in bank? c.
-

- a. At what intervals will the bank pass-book be balanced by the bank? a.
- b. Will all checks returned by the bank be compared and verified with their stubs, b.
4. so as to establish a proof between the

- cash-book balance and the pass-book balance after allowing for outstanding checks? c.
- c. How often will this proof be made? d.
- d. By whom will this proof be made? d.
-
- a. At what intervals will
- (a) The cash on hand and the cash-book balance be proved? (a)
- (b) The cash charged to bank on the cash-book be compared with the corresponding credit on the bank pass-book? (b)
5. (c) Disbursements be compared with vouchers? (c)
- (d) Cash-book footings be verified? (d)
- b. By whom will the foregoing verifications be made? b.
-
- a. How many times each year will the accounts and vouchers of the Employee's office be audited and compared, and all moneys reported as due (i. e., accounts receivable), on hand, and in bank, be verified? a.
6. b. Will this audit be made by an outside accountant? b.
- c. If by an employee, what is his position? c.
-
- a. What will probably be the largest amount of cash in the custody of the Employee at any one time? a.
- b. What will probably be the largest amount of money in bank at any one time under the control of the employee? b.
7. c. Will the Employee deposit daily in bank all bankable funds, and make disbursements only by check or out of funds drawn from the bank for such purposes? c.
- d. In what name will the bank accounts be kept? d.
- e.

- e. What signatures will be required on checks?
- f. What signatures on other negotiable instruments? f.....

- a. Will the Employee's duties include the handling or care of securities or funds belonging to the Employer? a.....
- b. Will such securities be negotiable by him? b.....
8. c. State how and where they will be deposited, and under what restrictions they will be withdrawn. c.....
- d. How often will such securities or assets be examined and verified with the Employee's accounts? d.....

Will the Employee be authorized to sign negotiable paper of any kind in behalf of the Employer?

9.

If so, please state the name of such paper (notes, bonds, warehouse receipts, stock certificates, etc.), showing in each case what officer will countersign. { countersigned by.....
 countersigned by.....
 countersigned by.....
 countersigned by.....
 countersigned by.....

- a. Will the Employee be charged with the custody or sale of merchandise for the Employer? a.....
- If so, what will be the nature of the merchandise, and what the maximum value of all the merchandise in his custody at any one time?
- b. State how much merchandise will be consigned, how disposed of, and how reported by the Employee to the Employer? b.....
10. c. How often will the merchandise on hand be inventoried and verified with the Employee's accounts? c.....
- d. In what way will this be done? d.....
- e. By whom will it be done? e.....

11. If the Employee acts as paymaster, what precautions will be taken to keep ficti-

tious items from the pay-roll, and to
safeguard pay-roll money in his cus-
tody?

-
- a. How often will statements be rendered to debtors? a.....
- b. Will such statements be compared with the ledger before they are sent? b.....
12. c. By whom will this comparison be made? c.....
- d. Will the Employee have access to the statements before they are mailed or delivered? d.....
-

The foregoing answers, statements, and representations are true
to the best of our knowledge and belief

Dated and signed at.....this.....
day of....., 192...

Signature:
(Full name of Employer or Assured)

Attested by..... By.....
(In case of corporation) (In case of partnership or corporation)

Official title: Official title:

Full address of Employer or Assured:

Business of Employer or Assured:

Amount of Bond: \$..... Date on which liability
is to begin:

Who will pay the premium:

SPECIMEN COPY OF INDIVIDUAL STANDARD
FIDELITY BOND

1 *THE..... COMPANY,.....*
2 *hereinafter called the Surety, does hereby agree to indemnify.....*
3 *.....*
4 *of....., hereinafter*
5 *called the Employer, against the loss, not exceeding.....*
6 *dollars, of any money or other personal property (including money*
7 *or other personal property for which the Employer is responsible)*
8 *through the fraud, dishonesty, forgery, theft, embezzlement, or wrong-*
9 *ful abstraction, of....., hereinafter called the*
10 *Employee, directly or in connivance with others, while the Employee*
11 *is engaged in the service of the Employer, while this bond is in force.*
12 *The foregoing agreement is subject to the following conditions:*
13 1. *The term of this bond begins on the.....day of.....*
14 19..., *and continues in force until terminated or canceled as here-*
15 *inafter provided. Whatever the term may ultimately prove to be,*
16 *the liability of the surety, either for a single default of the Em-*
17 *ployee or for any number of such defaults, and irrespective*
18 *of the time within the term when such default occur, shall in*
19 *no event exceed the penalty of the bond stated in line numbered*
20 *five hereof.*
21 2. *Without prejudice to the rights of the Employer as respects*
22 *anything that may occur during the period that the bond is in force,*
23 *the Surety may cancel this bond at any time by a written notice*
24 *stating when the cancellation takes effect, served on the Employer or*
25 *sent by registered mail to the Employer at the address hereinbefore*
26 *stated, at least thirty days prior to the date that the cancellation*
27 *takes effect. The Employer may cancel this bond by like notice to*
28 *the Surety. In case of such cancellation the unearned part of the*
29 *premium shall be returned to the Employer, if no claim is made*
30 *hereunder. The Surety's check served on the Employer, or sent by*
31 *registered mail to the Employer at the address hereinbefore stated,*
32 *shall be a sufficient tender of the said unearned premium.*
33 3. *In the event of the death of the Employee during the terms of*
34 *this bond, or of his suspension, dismissal, or retirement from the*
35 *service of the Employer during the said term, this bond shall there-*
36 *upon terminate without any action on the part of the Surety. The*
37 *right to make a claim hereunder shall cease at the end of six months*
38 *after the termination, expiration, or cancellation of this bond.*
39 4. *Upon the discovery by the Employer of any dishonest act on*

40 the part of the Employee the Employer shall, at the earliest practi-
41 cable moment, and at all events not later than five days after such
42 discovery, give written notice thereof addressed to the Surety at its
43 home office. Affirmative proof of loss under oath, together with full
44 particulars of such loss, shall be filed with the Surety at its home
45 office within three months after such discovery. Legal proceedings
46 for recovery hereunder may not be brought until three months have
47 elapsed after such proof of loss has been filed with the Surety, nor
48 brought at all unless begun within six months after such proof of
49 loss has been filed with the Surety. If any limitation set forth in
50 this condition or in condition numbered 3 above is prohibited by the
51 statutes of the state in which this bond is issued, the said limitation
52 shall be deemed to be amended to agree with the minimum period of
53 limitation permitted by such statutes.

54 - 5. Upon the discovery by the Employer of any dishonest act on
55 the part of the Employee this bond shall terminate, without any
56 action on the part of the Surety, as to any act committed thereafter
57 by such Employee.

58 6. If the Employer shall sustain any loss that might be made the
59 basis of a claim hereunder, and shall settle or compromise such loss
60 with the Employee without first securing the consent of the Surety
61 to such settlement or compromise, this bond shall thereupon become
62 void from the beginning.

63 7. In the event of a claim hereunder the Employer, whenever re-
64 quired by the Surety to do so, shall give the Surety all the information
65 and evidence possessed by the Employer, and shall, at the request and
66 cost of the Surety, aid in securing information and evidence, and
67 shall render all assistance (other than pecuniary assistance) that
68 the Employer can render, for the purpose of bringing to justice,
69 prosecuting and convicting criminally the Employee, and for the
70 purpose of enabling the Surety to procure reimbursement from
71 the Employee or his estate of any loss, damage, or expense sustained
72 by the Surety hereunder.

73 8. The Employer and the Surety shall share any recovery
74 (excluding insurance and reinsurance) made by either on account
75 of any loss in the proportion that the amount of the loss borne by
76 each bears to the total amount of the loss.

77 9. If the Employer be a corporation or co-partnership, the
78 liability of the Surety for any losses otherwise within the terms and
79 provisions of this bond shall extend only to such losses as are
80 caused directly by the personal defaults of the president, vice-
81 president, secretary or treasurer of such corporation or by the
82 individual members of such co-partnership.

83 *IN WITNESS WHEREOF, the Surety has caused this bond*
84 *to be signed by its President and its Secretary; but this bond shall*
85 *not be binding upon the Surety unless it shall be countersigned by a*
86 *duly authorized representative of the Surety.*

.....
Secretary.

.....
President.

Countersigned by
Authorized Representative.

SPECIMEN COPY OF CONTINUOUS SCHEDULE BOND

.....COMPANY

SCHEDULE BOND.

1 TheCOMPANY OF NEW YORK,
2 as Surety, binds itself to pay.....
3
4 as Employer, such pecuniary loss as the latter shall have sus-
5 tained of money or other personal property (including that for
6 which the Employer is responsible), by any act or acts of FRAUD,
7 DISHONESTY, FORGERY, THEFT, EMBEZZLEMENT, WRONGFUL
8 ABSTRACTION or WILLFUL MISAPPLICATION, directly or through
9 connivance with others, on the part of any of the employes
10 named in the schedule attached to and hereby made a part of
11 this bond, while in any position or at any location in the employ
12 of the Employer; the suretyship for any employe not to exceed
13 the amount specified in said schedule for such employe, and to
14 begin with the date set opposite the name of the employe and
15 to end, (a) with the date of the discovery by the Employer
16 either of loss thereunder or of dishonesty on the part of the
17 employe, or (b) with the date of the retirement of the employe
18 from the service of the Employer, or (c) with the date of the
19 termination of the suretyship by the Surety or the Employer in
20 the manner hereinafter set forth in clause 7.

21 *Provided, However:*

22 1. That loss be discovered during the continuance of the
23 suretyship for any defaulting employe or within the fifteen months
24 immediately following the termination thereof, and that notice
25 of such loss be delivered to the Surety at its home office in the
26 City of New York within ten days after such discovery.

27 2. That claim, if any, be submitted by the Employer in
28 writing, showing the items and the dates of the losses, and be
29 delivered to the Surety at its home office within three months
30 after such discovery, and that the Surety shall have two months
31 after claim has been presented in which to verify and to make
32 payment. In the meantime no suit, action or proceeding shall
33 be brought against the Surety by the Employer in respect to
34 such claim, nor after the expiration of twelve months after the
35 delivery of such statement of claim. In any suit, action or
36 proceeding the employe shall, if with reasonable diligence he
37 can be found within the jurisdiction, be made a party to the
38 suit and served with process therein.

39 3. That in no event shall the liability of the Surety for any
40 one or more defaults of any employe during any one or more
41 years of the suretyship for such employe exceed the amount
42 specified in said schedule for such employe.

43 4. That the Surety shall not be liable hereunder for any de-
44 fault the proceeds of which shall have been applied to the pay-
45 ment to the Employer of a pre-existing debt.

46 5. That in the event that the loss created by an employe
47 exceeds the amount of the suretyship for such employe, the
48 Employer and the Surety shall share with each other *pro rata* in
49 any net recovery, except recovery upon or from other surety-
50 ship, in the proportion that the amount of the payment under
51 the suretyship for the employe bears to the total shortage.

52 6. That the amount of suretyship on behalf of any employe
53 hereunder may, on written application of the Employer, be
54 increased or decreased by the Surety without impairing the
55 continuity thereof.

56 7. That the suretyship on any employe may be terminated by
57 the Surety upon thirty days' notice to the Employer, or by the
58 Employer upon notice in writing to the Surety specifying the
59 date of termination. Thereupon the Surety shall refund the
60 unearned premium for such suretyship if no claim has been paid
61 thereunder.

62 When suretyship is desired for other employes than those
63 named in the schedule hereinbefore mentioned in lines twelve
64 to fourteen the Employer shall make written application for such
65 suretyship, specifying the names of the employes and the
66 amount and the date of the commencement of the suretyship
67 required for each, and thereupon, if satisfactory to it, the
68 Surety shall become bound under the terms of this bond, for
69 such employes, notice in writing to that effect to be given the
70 Employer by the Surety, and such notice to be attached to
71 and made a part of said schedule.

72 *In Witness Whereof* the Surety has set its hand and seal this
73day of.....19

74COMPANY OF NEW YORK,
75 By.....

76 Attest:

President.

77
78

79 *Resident Assistant Secretary at*.....

SPECIMEN COPY OF STANDARD CONTRACT BOND

THE.....COMPANY OF NEW YORK

KNOW ALL MEN BY THESE PRESENTS:

That.....
 of....., State of.....
 hereinafter called the PRINCIPAL, and THE.....
 COMPANY OF NEW YORK, hereinafter called the SURETY, are
 held and firmly bound unto.....

of....., State of.....
 hereinafter called the OBLIGEE, in the sum of.....
Dollars:

for the payment whereof to the Obligee the Principal bind.....,
heirs, executors, administrators, successors, and
 assigns, and the Surety binds itself, its successors and assigns firmly
 by these presents.

Signed, sealed, and dated this.....day of....., 192 ..

WHEREAS the Principal and the Obligee have entered into a written
 contract, hereinafter called the CONTRACT, for.....

dated the.....day of....., 192 .., a copy of which
 is attached hereto:

NOW, THEREFORE, the condition of the foregoing obligation is such
 that if the Principal shall indemnify the Obligee for all loss that the
 Obligee may sustain by reason of the Principal's failure to comply
 with any of the terms of the contract, then this obligation shall be void;
 otherwise it shall remain in force.

The foregoing obligation, however, is limited by the following express
 conditions, the performance of each of which shall be a condition
 precedent to any right of claim or recovery hereunder:

1. Upon the discovery by the Obligee, or by the Obligee's agent or
 representative, of any act or omission that shall or might involve a loss
 hereunder, the Obligee shall give immediate written notice thereof with
 the fullest information obtainable at the time to the Surety at its home
 office.

2. If the Principal shall fail to comply with the provisions of the
 contract to such an extent that the contract shall be forfeited, the Surety

shall have the right and opportunity to assume the remainder of the contract and at its option to perform or sublet the same.

3. In the event of any breach of the provisions of the contract, the Surety shall be subrogated to all the rights and properties of the Principal arising out of the contract. All deferred payments, and any and all moneys and properties, that are then, or that may thereafter become, due to the Principal under or by virtue of the contract shall be credited upon any claim that the Obligee may make upon the Surety.

4. Legal proceedings for recovery hereunder may not be brought unless begun within twelve months from the time of the discovery of the act or omission of the Principal on account of which claim is made: but if the Surety shall assume the performance of the contract, the period within which legal proceedings for recovery hereunder may be brought shall be deemed extended twelve months beyond the date of failure of the Surety to perform the said contract. If any limitation set forth in this condition is prohibited by the statutes of the state in which this bond is issued, the said limitation shall be considered to be amended to agree with the minimum period of limitation permitted by such statutes.

5. The Principal shall be made a party to any suit or action for recovery hereunder, and no judgment shall be rendered against the Surety in excess of the penalty of this instrument.

6. The Surety shall not be liable for any damages resulting from strikes or labor difficulties, or from mobs, riots, fire, the elements, or acts of God, or for the repair or reconstruction of any work or materials damaged or destroyed by any such causes; nor for damages for injury to person; nor for the non-performance of any guarantees of the efficiency or wearing qualities of any work done or materials furnished or the maintenance thereof or repairs thereto; nor for the furnishing of any bond or obligation other than this instrument; nor for damages caused by delay in finishing such contract in excess of ten per cent of the penalty of this instrument.

7. No change shall be made in the plans and specifications forming part of the contract that shall increase the amount to be paid to the Principal more than ten per cent of the penalty of this instrument, unless the Surety's consent thereto shall be secured in writing.

8. The Obligee shall retain such proportion as the contract specifies that the Obligee shall or may retain of the value of all work performed or materials furnished in the prosecution of the contract (but not less in any event than ten per cent of such value) until the Principal has completely performed all the terms, covenants, and conditions of the contract to be performed by the Principal.

9. No right of action shall accrue hereunder to or for the use or benefit of any one other than the Obligee, and the Obligee's rights hereunder may not be assigned without the written consent of the Surety.

IN WITNESS WHEREOF, this instrument has been executed by the duly authorized representatives of the Principal and the Surety.

.....
The.....Company.

By.....
Attorney.

CHAPTER XXX

TITLE INSURANCE

General Nature of the Protection Offered.—*Known defects not assumed.*—A title insurance policy promises to protect the owner of real estate, or the lender of money thereon, against loss or damage, not exceeding the amount stated in the policy, sustained by reason of any defect of title assumed under the policy and affecting the premises described in the policy, or because of the unmarketability of the title, or by reason of unknown liens or encumbrances against the property at the time the policy is issued. Such policies protect only against loss arising from defects in the title which existed prior to the issuance of the policy, and do not cover defects originating subsequent to the date in the contract. In other words, the title insurance policy relates essentially to the past; it protects the title as it stands when the policy is written, and is unique among all the various types of insurance in that it “ends where other insurance begins, namely, at the date of the policy.”

A title insurance policy is written by the company on the theory that no known risks are assumed. Before issuing the policy the company undertakes a careful examination of all the records and facts which may have a bearing upon the title to the premises which it is proposed to insure, with a view to discovering all defects that may exist. If any are found, they are carefully described in the policy, and then declared to be risks for which the company cannot be held liable. Title in-

surance thus promises to pay only those losses which result from errors made in the examination of the title from the records, or from defects which were not discovered because they were not recorded. In this connection, it should be remembered, that there is always a possibility that records relating to real estate may be wrongly interpreted. Lawyers may differ as to the effect which certain instruments or court proceedings will have upon the legality of a title, and their conclusions may be either imperfect or mistaken.

Term of the contract.—A title insurance policy proves advantageous in that, unless special conditions to the contrary are inserted, it guarantees the title for all time to come. In this respect title insurance is again unique in that its term runs indefinitely into the future. With consent of the company, the holder may assign the policy to subsequent purchasers or creditors, who then are protected against any loss resulting from defects in the title prior to the original date of the policy. It must be distinctly understood, however, that such purchasers are not protected against defects which arise after the issuance of the policy and prior to the assignment.

The premium.—As the term of the policy runs indefinitely into the future, so the premium is paid but once when the policy is issued, and no further payment need ever be made so long as no change of title occurs. A great variety of premium charges exist in different sections of the country, depending chiefly upon the company, the kind of policy, and the conditions prevailing in the particular locality. For "owners' policies" the following insurance fees are probably fairly representative: \$5 per thousand of the market value of the insured property up to \$25,000, \$4 per thousand over \$25,000 to \$50,000, \$3 per thousand over \$50,000 to \$100,000, and \$2.50 per thousand over \$100,000. For "mortgagees' policies" a

fairly representative rate is \$3.50 per thousand of the amount of the loan up to \$50,000, and \$2.50 per thousand over \$50,000. To these insurance fees, however, there is added the cost of examining the title and certain other service items.

Realizing that the holder of a policy may, at the request of a purchaser or mortgagee, desire a new policy to cover the title to the date of sale or loan, the companies grant such policies in certain localities at a reduced rate. The policy provision with respect to this feature usually reads: "Whenever the holder of a policy of this company, provided the estate or interest insured thereby is a fee or leasehold, shall within seven years from the date of that policy, sell or mortgage any or all of the real estate therein described, and shall within thirty days thereafter apply for a new policy on the same title, to be issued to the grantee or mortgagee, then if the risk be again accepted by this company, the former policy shall be surrendered and canceled and the new policy will be issued upon payment of the then scheduled reissue rate therefor." Where allowed, such reduction in premium on the new policy is usually 40 or 50 per cent.

Examination of Titles by Title Insurance Companies.

—Formerly it was necessary for the owner of property, who desired the title to be examined, to engage a lawyer to search the records and to make an abstract thereof. If in his opinion, the title was good, certification would be made to that effect on the abstract, and this opinion constituted the certificate of title. The shortcomings of such a method are apparent, especially when we reflect that the records of many counties, affecting titles, involve several hundred different kinds of legal instruments, extend over many decades and sometimes over a century, and often require thousands of volumes for their recording. Even assuming that the party making the search is

diligent, there may be important facts not disclosed by the record at all. There is also always the possibility that existing records may involve forgeries or inaccurate entries. Moreover, the legal opinion of the lawyer supporting abstracts and searches is simply an unsupported expression of opinion as to the validity of the title, and may prove entirely wrong.

At present, in the larger cities, where real estate transactions are numerous and where the records have become very complex and voluminous, nearly all of the abstracting of titles is done by large title or guarantee companies, which have prepared elaborate "tract" or "abstract plants" covering practically all real estate in a given county or other geographic section. These plants, constituting the chief asset of most title insurance companies and usually prepared at great expense, are so arranged that the company has a classified index of all records with respect to practically every tract of land within a given area. The companies usually have employees in the various record offices so that their abstract plants are kept strictly up to date. They also have expert legal departments which examine all court proceedings as well as points of law affecting titles, and which advise the searching and examining departments. It should also be added that most title insurance companies limit their operations to a particular locality, although in recent years a few companies have undertaken the assumption of risks throughout most of the country. Such a national service, it is clear, proves of benefit to life insurance and other investing companies whose real estate investments are also national in their distribution. .

Losses Paid by Title Insurance Companies.—Title insurance, as previously stated, is based upon the theory that no insurance is granted against known defects, and that the companies write such policies on the assumption

that the examination has been made so carefully that in all probability no loss will arise under the policy. The reports of various title insurance companies show that the losses paid are trivial when compared with the total amount of business done, and that the premium income is expended chiefly in the prevention of loss through careful search, legal examination, etc. About half of the companies reported in the *Insurance Year Book* show no losses whatever during most years, and even the very largest companies suffer only trivial losses. Of 35 companies reporting their premium income to the *Insurance Year Book* for 1919, only 17 are mentioned as having incurred any loss for that year. The aggregate loss, however, amounted to only \$298,738, as compared with an aggregate premium income of \$12,091,125. The two largest companies, with premiums of \$3,911,000 and \$1,820,000, respectively, during 1919, incurred losses for that year of only \$197,000 and \$47,000.

Types of Policies.—Title insurance policies differ considerably in their terms, owing partly to varying conditions prevailing in different localities, but chiefly to the desire of policyholders for special forms to meet peculiar interests in property. Broadly speaking, however, policies may be divided into two main classes, namely, “owners’ policies” and “mortgagees’ policies.”

Leading Provisions of Owners’ Policies.—*The insuring clause.*—

The Company, in consideration of the payment of its charges for the examination of title and of the premium named above, insures heirs and devisees, against all loss or damage not exceeding \$. which the insured shall sustain by reason of any defect or defects of title affecting the premises described in Schedule A, hereto annexed, or affecting the interest of

the insured therein, as described in said schedule, or by reason of unmarketability of the title of the insured to or in said premises, or by reason of liens or incumbrances charging the same at the date of this policy; SAVING all loss and damage by reason of the estates, interests, defects, objections, liens and incumbrances excepted in Schedule B, or by the conditions of this policy, hereto annexed and hereby incorporated into this contract, the loss and the amount to be ascertained in the manner provided in said conditions and to be payable upon compliance by the insured with the stipulations of said conditions, and not otherwise. It is expressly understood and agreed that any loss under this policy may be applied by this Company to the payment of any mortgage mentioned in Schedule B, the title under which is insured by this Company, or which may be held by this Company, and the amount so paid shall also be deemed a payment to the insured under this policy. The aggregate liability of this Company under this policy and any policy issued to the holder of any such mortgage, shall not exceed the amount of this policy.

The insuring clause, it should be noted, is immediately followed by another clause which extends the company's liability to the defense of suits, founded on a claim of title, in these words:

The COMPANY will, at its own cost, defend the insured in all actions or proceedings founded on a claim of title or incumbrance prior in date to this policy and thereby insured against. This Company shall have the right, at its own cost, to maintain or defend any action relating to the title hereby insured, or upon or under any covenant relating to such title.

The above-mentioned sections of the policy clearly indicate that the company does not undertake to assume known risks, or risks for which the insured is personally respon-

sible. Considerable blank space is provided in the policy under each of the two captions, "Schedule A" and "Schedule B." Schedule A is intended to furnish a full description of the premises with respect to (1) the estate or interest of the insured in the premises covered by the policy, (2) the deed or other means by which such estate or interest is vested in the insured, and (3) the premises in which the insured has the estate or interest. Schedule B exists to furnish a full statement of all "estates, interest, defects, objections to title, liens, charges, and incumbrances affecting said premises, or the estate or interest insured," against which the policy does not insure. In this manner the policy exempts the company from loss due to defects or incumbrances mentioned in the policy itself. Furthermore the company is exempt from loss due to judgments against the insured, or defects, objections, liens, or incumbrances, granted by the act or with the knowledge of the insured. (For specimen copy of owners' policy see p. 513.)

Conditions under which the company becomes liable.—Aside from the defense of the insured in legal actions, no claim for damages is to be paid under the policy, except in the following cases:

(1) Where a final judgment has been rendered in a court of competent jurisdiction which may result in the dispossession or eviction of the insured from the premises covered by the policy, or from some part or undivided share or interest therein.

(2) Where an adverse final judgment has been rendered in a court of competent jurisdiction upon a lien or incumbrance not excepted in the policy.

(3) Where the insured has contracted in writing to sell the estate or interest covered by the policy, and the title has been rejected because of a defect or incumbrance not excepted by the policy. In such cases, where notice of the rejection is furnished to the company, the company may

exercise the option usually within thirty days thereafter, either of paying the loss or maintaining some proper action in the name of the insured at its own cost, the company, however, not to be liable until final judgment is rendered in the suit.

(4) Where the interest of a mortgagee has been insured, and the mortgage has been finally adjudged invalid or ineffectual or subject to a prior lien or incumbrance not excepted in the policy.

(5) Where a purchaser, at a sale under the judgment or order of the court, has been relieved from the purchase by the court owing to the existence of some lien, incumbrance or defect of title not excepted in the policy.

(6) Where the insured has negotiated a loan on the security of a mortgage on the insured estate or interest, and the lender rejects the title because of some defect or objection not excepted in the policy. In such cases the company agrees to submit the question of the validity of the title at its own expense to the proper judicial tribunal, and agrees that its liability shall depend upon the judgment of that court.

(7) Where the insured has transferred the insured title by an instrument containing covenants in regard to the title, and a final judgment is rendered against the insured on any of such covenants because of a defect in the title covered by the policy.

Excluded risks.—Aside from the excepted risks enumerated under Schedule B, an owner's policy usually contains five additional restrictions upon the company's liability, namely:

(1) The policy does not "guarantee against the consequences of the exercise and enforcement or attempted enforcement of Governmental police powers" over the insured property.

(2) Unless specifically declared to the contrary, the

policy does not insure any title or rights of the insured "in any premises beyond the lines of the premises as described in Schedule A, or in any streets, roads, avenues, lanes, or ways on which the said premises abut, except the ordinary rights of light, air and access belonging to abutting owners." Nor does the policy insure "that the buildings or other erections upon the premises comply with state and municipal laws, regulations and ordinances."

(3) Coverage under the policy does not extend to the title to any personal property, attached to or used in connection with the insured premises.

(4) Should the insured premises be "subsequently improved or altered and the cost thereof exceeds 20 per cent of the amount insured hereunder, such proportion only of any loss established shall be borne by the company as 120 per cent of the amount of this policy bears to the total value of the property as improved." Should the insured premises, as described in Schedule A, "be divisible into separate independent parcels and a loss is established affecting one or more of said parcels, the loss shall be computed and settled on a pro rata basis as if this policy was divided pro rata as to value of said separate independent parcels, exclusive of improvements made subsequent to the date of the policy."

(5) The policy does not extend to (a) defects and incumbrances arising after the date of the policy, (b) those created, suffered, or agreed to by the insured, and (c) "taxes and assessments which have not become a lien up to the date of this policy or which are payable in future installments."

Prohibited acts on the part of the insured invalidating the policy.—Any untrue statement of the insured or his agent with respect to any material fact, or any suppression of or failure to disclose any such fact, is held as avoiding the policy. An innocent assignee for value of the policy

(with the company's endorsed consent) is not, however, held affected by the insured's false statements or suppressions. The insured is also prohibited, under penalty of having his policy invalidated, from effecting a transfer of the policy, except with the approval of the company endorsed on the policy by its proper officer.

Duties of the insured.—Should any action or proceeding be begun with the object of impugning, attacking or calling in question the validity of the insured title or of raising any material question with respect to any claim of incumbrance insured against, the insured is obligated by the terms of the policy at once to notify the company in writing. Failure to give such notice within ten days after the service of the first summons or other process will render the policy void. Where the company undertakes to prosecute or defend, as per its policy rights, the insured is required to secure to the company "the right and opportunity to maintain or defend the action or proceeding, and all appeals from any determination therein, and to give it all reasonable aid therein, and to permit it to use at its option the name of the insured." Innocent assignees for value of the policy, however, are protected against the insured's failure to comply with any of the above-mentioned requirements. The policy also usually provides that: "the company will pay, in addition to the loss, all costs imposed on the insured in litigation carried on by it for the insured under the requirements of this policy; but it will in no case be liable for the fees of any counsel or attorney employed by the insured; and the costs and loss paid shall not together exceed the amount of this policy." Should a claim be settled under the policy, the company is entitled to any rights and remedies of the insured against any person or property in respect to such claim. The insured also agrees to transfer to the company all such rights and to permit it to use his name for the recovery or defense of the claim.

Settlement of claims.—The time of payment, the valuation of the insured estate or interest by arbitration, the right of the company to appeal from any adverse determination, and the options of settling a claim, are set forth as follows in Section 8 of the standard form approved by the New York Board of Title Underwriters:

In every case where the liability of this company has been definitely fixed in accordance with these conditions, the loss or damage shall be payable within thirty days thereafter. Provided, however, that in every case this company may demand a valuation of the insured estate or interest, to be made by three arbitrators or any two of them, one to be chosen by the insured and one by this company, and the two thus chosen selecting an umpire; and then no right of action shall accrue until thirty days after such valuation shall have been served upon this company, and the insured shall have tendered a conveyance or transfer of the insured estate or interest to a purchaser to be named by this company, at such valuation, less the amount of any incumbrance on said insured estate or interest not hereby insured against, and this company shall have failed within that time, said tender being during that time kept good, to find a purchaser for the estate or interest upon such terms. And provided, also, that this company shall always have the right to appeal from any adverse determination; but no appeal shall operate to delay the payment of the loss, if the insured shall give to this company satisfactory security for the repayment to this company of the amount of such loss in case there shall be, ultimately, a determination in favor of this company. And provided, further, that in every case, this company shall have the option of settling the claim or paying this policy in full; and the payment or tender of payment to the full amount of this policy shall determine all liability of this company under it. All payments under this policy shall reduce the amount of the insurance *pro tanto*. No payment or settlement can be demanded without producing

this policy for indorsement of the fact of such payment or settlement. If this policy be lost, indemnity must be furnished to the satisfaction of this company.

Leading Provisions of Mortgagees' Policies.—*Nature of the coverage.*—This type of policy does more than protect the insured against defects in title. It guarantees to the owner of the policy and the bond and mortgage described in Schedule A (1) "payment of interest at the rate of per cent, per annum, subject to such deduction for income tax as may be required by law, computed from 192.. within five days after the same shall have become due under the terms of said bond and mortgage upon the amount of the principal sum hereby guaranteed at any time outstanding until said principal sum shall be wholly paid"; and (2) "payment of the principal sum of \$...... secured by said bond and mortgage as and when collected, but in any event within eighteen months after payment shall be demanded by the insured provided such demand be made after said principal sum shall have become due under the terms of the said bond and mortgage."

Under the terms of the policy, the insured irrevocably appoints the company as his exclusive agent, at its own expense, (1) "to sue for and receive the proceeds of any policy of title insurance and of any policy of fire insurance covering the mortgaged premises"; (2) to collect the interest on the bond and mortgage guaranteed by the policy; and (3) to exercise every option or privilege given to the mortgagee by either the bond or mortgage. The insured also agrees "to refrain from exercising any such option or privilege and from collecting any part of said interest or of the principal secured by said bond and mortgage except through the company and to permit the company to retain as its premium for this guarantee all interest

collected in excess of the rate guaranteed above." (For specimen copy of mortgagees' policy see p. 520.)

Obligations of the company.—The agreements and conditions of the policy are divided into two sections, namely, those undertaken by the company, and those to be observed by the insured. The company agrees:

(1) "To institute and conduct as and when it may deem expedient but without expense to the insured all such proceedings as may be necessary to enforce payment of said bond and mortgage or the fulfillment of the other covenants and agreements contained therein."

(2) "To keep the title to the mortgaged premises guaranteed to the amount of this policy during the life hereof."

(3) "To keep the mortgaged premises adequately insured against fire and to require the owner thereof to pay all such taxes, assessments and water rates and all such fire insurance premiums as by the terms of the mortgage are required to be paid."

(4) To guarantee the insured mortgage as "a valid first lien on a good and marketable title in fee to the property therein described."

Obligations of the insured.—The insured agrees:

(1) To give the company prompt notice in writing of any assignment of the insured bond and mortgage or of any action or proceeding affecting the bond and mortgage and of which he receives knowledge.

(2) To forward to the company promptly all notices relating to any fire insurance policies on the mortgaged premises.

(3) To permit the company, but at its own expense, to enforce payment of the mortgage in the name of the insured, either by foreclosure or otherwise. In this respect the insured agrees to give the company every assistance by way of producing all necessary papers and proofs. The company is also authorized to receive out of the proceeds

of such action any sum remaining after the insured has been paid whatever may be due him for principal and interest at the guaranteed rate.

(4) To permit the company, in the event of no bid being received in any foreclosure sale sufficient to cover the judgment and expenses of the sale, to buy in the property covered by the bond and mortgage and to take title thereto in the name of the insured. Until full payment of the insured's claim, the company is entitled to the possession, management and control of the property thus bought in. Following full settlement of the claim, however, the company becomes entitled, according to the policy, to the conveyance of the property to it or its nominee by the insured or his legal representatives.

(5) To assign and deliver the bond and mortgage to the company, upon its request, whenever the insured is entitled to require payment thereof and has received from the company the full amount due under the policy.

Services Rendered by Title Insurance.—Having explained the provisions of the leading types of policies, we may next summarize the advantages derived from title insurance. Despite the few losses incurred by title insurance companies, there is a sufficiently large element of risk attached to titles to make this form of insurance a convenient help to those who own real estate. The various advantages of title insurance, if issued by a reliable company, may be summarized as:

(1) Protecting the owner of property, or the lender of money thereon, against any unknown defect in the title to the property under consideration. One company¹ enumerates the following as constituting some of the difficulties that may occur in any title: invalid wills, defective

¹ New York Title and Mortgage Company: Pamphlet on Title Insurance Protection to Real Estate Owners and Investors.

probate of wills, dower claims, forgery, defective foreclosures, deeds executed by infants, copyists' errors, deeds executed by lunatics, false affidavits, claims to old lanes and roads, liens omitted from searches, false personations, defective suits, undiscovered heirs, defective acknowledgments, mistakes of law, invalid power of sale, undiscovered wills, law suits, mistakes in descriptions, mistakes of facts, after-born children, illegal trusts, and undisclosed restrictions.

(2) Freeing the owner, or lender of money, from all worry as to possible loss because of a defective title resulting from a faulty examination of the public records. As regards the examination of the title, a title insurance company renders all the service given by any other system, the charge including the cost of making a thorough examination. According to law, the abstractor of a title agrees with his employer to furnish a summary of the records relating to all grants, conveyances, wills, liens and incumbrances, judicial proceedings, mortgages, taxes, assessments, etc., which pertain to his title. The task requires skill, and the law holds the abstractor liable in case any loss results because he has not made all the necessary searches, or has not performed his work with "due care," or has certified to something which is incorrect. But the law in this respect can be little more than a form; for, supposing that the abstractor is guilty of any of the above acts, how many possess the financial resources to indemnify the holder of the title for loss resulting from a serious mistake? Nor can the abstractor be held liable for not calling the owner's attention to defects in title which are not within the public records. A large company, with its big capital and surplus, on the other hand, can give assurance that if its work is not well done, or in case there are defects not contained within the public records, the owner will be indemnified for any loss he may suffer. At the close of

1920, for example, 35 title insurance companies reported an aggregate capital of \$30,765,000 and surplus of \$34,301,000, or an average capital and surplus per company of nearly \$1,900,000.

(3) Giving security against loss resulting from errors of judgment on legal questions involved in the title. As has been stated, "the title insurance policy is a contract to indemnify; not a mere expression of personal opinion."

(4) Insuring against loss resulting from defects which, because they are not in the public records, cannot be discovered from an examination of the same by an abstractor, such as the forgery of instruments, the making of a deed by an attorney-in-fact, whose power was fabricated, or under the power of an attorney after the death of the principal, which renders it void, acts of insane persons or minors, improper probate proceedings, and failure of all parties to sign an instrument.

(5) Making real estate more readily saleable and facilitating the borrowing of money thereon. To an increasing degree buyers and lenders demand an evidence of title that is concise, clear and certain. Title insurance makes it possible to meet this demand, since it guarantees purchasers and lenders against any possible loss by reason of fraud or error in the evidence of title, and at a cost not out of proportion to the value of the property involved.

(6) Defending the insured in the event of any law-suit involving the title.

(7) Protecting mortgagees, as will be explained later in connection with guaranteed mortgage investments, against the loss of interest and principal from any cause whatever.

Guaranteed First Mortgages.—*Mortgage certificates secured by individual mortgages.*—A considerable number of large mortgage companies sell mortgage participation certificates that are insured against loss of interest, principal and title. In most instances, the title to the property

that secures the mortgage is insured by a title insurance company, and the certificates are then issued for any sum, upward of \$200, and insured as to principal and interest by a subsidiary company. Generally, the mortgage company adheres to certain limitations that aim to safeguard its business, such as limiting the volume of guaranteed mortgages to the extent of ten times its capital and surplus. To make such limitation practically irrevocable, such companies usually provide in their by-laws that the limitation is "not to be amended or repealed except with the written consent, duly acknowledged, of the owners of all the policies of mortgage insurance then outstanding and issued by the company." Furthermore, the loans of the company are usually limited to a certain definite territory and to certain designated income producing business or residence properties.

The profit of the mortgage company is usually limited to one-half of 1 per cent, the difference between the one-half of 1 per cent retained by the company and the interest paid by the borrower being received by the certificate holder. Thus, if the borrower pays 6 per cent or $5\frac{1}{2}$ per cent on his loan, the investor in guaranteed mortgage certificates will receive $5\frac{1}{2}$ or 5 per cent, usually payable in semi-annual installments. In return for the retained $\frac{1}{2}$ per cent, the company acts as agent of the investor for the collection of interest. It will also look after the fire insurance, the payment of taxes and assessments, and all other matters which the mortgagor should attend to. The company also protects the certificate holder with a policy providing for the payment of interest the day it is due, and for the payment of the principal of the mortgage at maturity after collection from the mortgagor, or in any event within eighteen months after maturity, the regular semi-annual interest being paid meanwhile. The policy usually contains no exceptions as to loss resulting

from fire, riot, tornado, earthquake, defects in title or any other cause.

The property covered by the mortgage, the company's appraisal of the value of the property, the period of time for which the mortgage has to run before maturity (usually 3 to 5 years, although mortgages for shorter terms are available because, at the time of purchase of the certificates they may already have run for some length of time), and the rate of interest are submitted for the investor's consideration. Each certificate assigns and gives title and ownership of the particular mortgage selected to the extent of the amount of the certificate. "This ownership," as stated in the literature of one leading company, "belongs to the purchaser independently and apart from the company's guaranty and apart from the company's rights and interest in the mortgage, except as the company acts as the agent of the certificate holder." The papers, including the bond and mortgage, together with the policy guaranteeing principal and interest, and all incidental securities, are held in trust by the company as depository and agent for the holders of certificates which, it is promised, "shall never aggregate more than the amount of principal remaining unpaid on said bond and mortgage."

Not only are certificate holders protected because of the expert service given them in the appraisal and selection of the security back of the mortgage, but because of the large assets of the mortgage company, or the title insurance company, as the case may be, they are protected against loss from any defect in title to the property or failure on the part of the borrower for any reason to pay interest or to repay the principal. Moreover, the mortgage loans are distributed in various amounts on property of various kinds and located in different localities, so that investors have the benefit of the security associated with a sufficiently broad spread of business. Certificate holders also have the

advantages of: (1) investment in amounts suited to the convenience of the buyer, (2) inspection of the particular property, if they so wish or of seeking advice regarding its value, (3) having all matters connected with the mortgages looked after by the mortgage company, and (4) relief from all troubles connected with possible foreclosure proceedings since in that event the mortgage company buys the property and settles with the holder of the guaranteed certificate as per its terms. It may also be added that these certificates have been authorized in various leading states as legal investments for funds of savings banks, trust companies, insurance companies, trustees, executors, administrators, and guardians.

Mortgage certificates secured by groups of mortgages.—As contrasted with the foregoing type of mortgage certificate, there may be mentioned another type "secured by a group of mortgages, together standing as security for all certificates issued, without direct relation between a particular certificate and a particular mortgage."² These certificates are also protected by carefully selected and insured first mortgages which, as in the case of the other type of certificates, are held in trust for the holders. Such certificates are usually issued in denominations of \$50, \$100, \$500, and \$1,000, for the term of ten years. The company, however, reserves the right of redemption, as a rule, at any time, on due notice, after five years. Holders are also given the privilege of returning one or more certificates at any time in payment or part payment of any guaranteed mortgage purchased from the company.

Guaranteed first mortgages.—In contrast to either of the aforementioned methods of selling certificates, the investor may be given the privilege of selecting a mortgage, say for \$10,000, from a list of mortgages purchased by the

² As described by the Lawyers Title and Trust Company.

company. Upon payment of the same, the purchaser will have the mortgage of record assigned to him, and will be given the note, the mortgage, the title and fire insurance policies, and a mortgage insurance policy guaranteeing a fixed net rate of interest as well as repayment of the principal.

Safety of guaranteed mortgage investments.—Judging from reports of several of the largest mortgage companies, guaranteed mortgage investments, insured as to interest, principal, and title of the mortgaged property, have furnished a safe and reasonably profitable investment. Two large companies, for example, with a record extending over a quarter of a century, have sold respectively over \$1,000,000,000 and \$825,000,000 of guaranteed mortgage investments without the loss of a dollar to any investor. The last company was obliged during the recent war, the worst period in its history, to bring nearly 2,000 foreclosure suits, and bought in nearly \$4,600,000 of property. Owing to the large assets of the company, this did not concern any of the investors in mortgages or certificates relating to the properties involved. In fact, the company passed through this difficult period without strain, continued the payment of regular dividends and added substantially to its surplus.

SPECIMEN COPY OF OWNERS' TITLE INSURANCE
POLICYOwner's Policy *PREMIUM \$.....**RATE, 1/10th of 1% less 40% of
premium on Prior Insurance,
if any.*
POLICY No.

THE.....COMPANY

POLICY OF TITLE INSURANCE

The.....COMPANY, in consideration of the payment of its charges for the examination of title and of the premium named above, insures

heirs and devisees, against all loss or damage not exceeding

dollars which the insured shall sustain by reason of any defect or defects of title affecting the premises described in Schedule A, hereto annexed, or affecting the interest of the insured therein, as described in said schedule, or by reason of unmarketability of the title of the insured to or in said premises, or by reason of liens or incumbrances charging the same at the date of this policy; *saving* all loss and damage by reason of the estates, interests, defects, objections, liens and incumbrances excepted in Schedule B, or by the conditions of this policy, hereto annexed and hereby incorporated into this contract, the loss and the amount to be ascertained in the manner provided in said conditions and to be payable upon compliance by the insured with the stipulations of said conditions, and not otherwise. It is expressly understood and agreed that any loss under this policy may be applied by this Company to the payment of any mortgage mentioned in Schedule B, the title under which is insured by this Company, or which may be held by this Company, and the amount so paid shall also be deemed a payment to the insured under this policy. The aggregate liability of this Company under this policy and any policy issued to the holder of any such mortgage, shall not exceed the amount of this policy.

In witness whereof the.....COMPANY
has caused its corporate seal to be hereunto affixed and these presents
to be signed by two of its officers this

.....*Vice-President.*

.....*Asst. Secretary.*

SCHEDULE A

1. The estate or interest of the insured in the premises described below, covered by this policy.

(A large space is here reserved.)

2. The deed or other means by which the estate or interest covered by this policy is vested in the insured.

(A large space is here reserved.)

3. The premises in which the insured has the estate or interest covered by this policy.

(A large space is here reserved.)

SCHEDULE B

This policy does not insure against such estates, interests, defects, objections to title, liens, charges and incumbrances affecting said premises, or the estate or interest insured, as are set forth below in this Schedule.

(A large space is here reserved.)

CONDITIONS OF THIS POLICY.

(Standard Form approved by the New York Board of Title Underwriters.)

1. The.....COMPANY will, at its own cost, defend the insured in all actions or proceedings founded on a claim of title or incumbrance prior in date to this policy and thereby insured against. This Company shall have the right, at its own cost, to maintain or defend any action relating to the title hereby insured, or upon or under any covenant relating to such title.

2. No claim for damages shall arise under this policy except under section I of these conditions, and except also in the following cases: (I) Where there has been a final determination in a court of competent jurisdiction, under which the insured may be dispossessed or evicted from the premises covered by this policy or from some part or undivided share or interest therein. (II) Where there has been a final determination adverse to the title, as insured, in such a court upon a lien or incumbrance not excepted in this policy. (III) Where the insured shall have contracted in good faith in writing to sell the insured estate or interest, and the title has been rejected because of some defect or incumbrance not excepted in this policy, and notice in writing of such rejection shall have been given to this company within ten days thereafter. For thirty days after receiving such notice this company shall have the option of paying the loss, of which the insured must present proper proof, or of maintaining or defending either in its own name or at its option in the name of the insured some proper action or proceeding, begun or to be begun in a court of competent jurisdiction, for the purpose of determining the validity of the objection alleged by the vendee to the title, and only in case a final determination is made in such action or proceeding, sustaining the objection to the title, shall this company be liable on this policy. (IV) Where the insurance is upon the interest of a mortgagee, and the mortgage has been adjudged, by a final determination in a court of competent jurisdiction, to be invalid, or ineffectual to charge the premises described in this policy, or subject to a prior lien or incumbrance not excepted in this policy. (V) Where a purchaser at a sale under the judgment or order of a court of competent jurisdiction has been relieved by the court from a purchase of the insured estate or interest by reason of the existence of some lien, incumbrance or defect of title not excepted in this policy. (VI) Where the insured shall have negotiated a loan on the security of a mortgage on an estate or interest in land insured by this policy, and the title shall have been rejected by the proposed lender, this company, if there is no dispute as to the facts, will consent to the submission of the question of the validity of the title, as insured, to the Appellate Division of the Supreme Court in the Judicial District in which is situated the property affected by this policy, if said property be in the State of New York, and, if said property be elsewhere, then to some court of competent jurisdiction, and upon the judgment of such court shall then depend the liability of this company, but in no event shall this company be obligated to make

any loan in place of the one so rejected. (VII) Where the insured shall have transferred the title insured by an instrument containing covenants in regard to title or warranty thereof, and there has been a final judgment rendered in a court of competent jurisdiction against the insured, or the heirs, executors, administrators or successors of the insured on any of such covenants or warranty, and because of some defect of title or incumbrance not excepted in this policy.

3. Whenever the holder of a policy of this company, provided the estate or interest insured thereby is a fee or leasehold, shall within seven years from the date of that policy, sell or mortgage any or all of the real estate therein described, and shall within thirty days thereafter apply for a new policy on the same title, to be issued to the grantee or mortgagee, then if the risk be again accepted by this company, the former policy shall be surrendered and canceled and the new policy will be issued upon payment of the then scheduled reissue rate therefor.

4. No transfer of this policy shall be made, except that a policy held by the owner of a mortgage or other incumbrance may be transferred to the purchaser at a foreclosure sale where the property sold is bought in by or for the insured, and except also in such other cases as this company may, by special written agreement, permit; but no transfer of this policy shall be valid unless the approval of this company is indorsed hereon by its proper officer. Such approval may in any case be refused at the option of this company, and all interest in this policy (saving for damages accrued) shall cease by its transfer without such approval, so indorsed. The liability of this company to any collateral holder of a policy shall in no case exceed the amount of the pecuniary interest of such collateral holder in the premises described in the policy.

5. Any untrue statement made by the insured, or the agent of the insured, with respect to any material fact; any suppression of or failure to disclose any material fact; any untrue answer, by the insured, or the agent of the insured, to material inquiries before the issuing of this policy, shall avoid this policy. But an assignee for value of this policy with the consent of this company indorsed on this policy shall not be affected by such untrue statements or answers, or by such suppressions or breach of warranty in the application of which the assignee was ignorant at the time the assent to the transfer to that assignee was indorsed by this company.

6. In case any action or proceeding described in section 1 of these conditions, is begun, or in case of the service of any paper or pleading, the object or effect of which shall or may be to impugn, attack or call in question the validity of the title hereby insured, as insured, or to raise any material question relating to a claim of incumbrance hereby insured against, or to cause any loss or damage for which this company shall or may be liable under or by virtue of any of the terms or conditions of this policy, or in case any action or proceeding is begun that may have such object or effect, it shall be the duty of the insured at once to notify this company in writing. In such cases and in all cases where this policy requires or permits this company to prosecute or defend, it shall be the duty of the insured to secure to it the right and opportunity to maintain or defend the action or proceeding, and all appeals from any determination therein, and to give it all reasonable aid therein, and to permit it to use at its option the name of the insured. If such notice shall not be given to this company within ten days after the service of the first summons or other process in such action or proceeding, or after the service of such paper or pleading, then this policy shall be void. Provided, however, that an assignee for value of this policy, with the consent of this company thereon indorsed, shall not be affected by any such failure to notify, if such assignee, through ignorance of the fact of such service having been made, shall have been unable to give or cause to be given the notice required by these conditions; and provided, also, that no failure to give such notice shall affect this company's liability, if such failure has not prejudiced and cannot in the future prejudice this company. This company will pay, in addition to the loss, all costs imposed on the insured in litigation carried on by it for the insured under the requirements of this policy; but it will in no case be liable for the fees of any counsel or attorney employed by the insured; and the costs and loss paid shall not together exceed the amount of this policy.

7. In every case where the liability of this company has been definitely fixed in accordance with these conditions, the loss or damage shall be payable within thirty days thereafter. Provided, however, that in every case this company may demand a valuation of the insured estate or interest, to be made by three arbitrators or any two of them, one to be chosen by the insured and one by this company, and the two thus chosen selecting an umpire; and then no right of action shall accrue until thirty days after such valuation shall have been served upon this company, and the

insured shall have tendered a conveyance or transfer of the insured estate or interest to a purchaser to be named by this company, at such valuation, less the amount of any incumbrance on said insured estate or interest not hereby insured against, and this company shall have failed within that time, said tender being during that time kept good, to find a purchaser for the estate or interest upon such terms. And provided, also, that this company shall always have the right to appeal from any adverse determination; but no appeal shall operate to delay the payment of the loss, if the insured shall give to this company satisfactory security for the repayment to this company of the amount of such loss in case there shall be, ultimately, a determination in favor of this company. And provided, further, that in every case, this company shall have the option of settling the claim or paying this policy in full; and the payment or tender of payment to the full amount of this policy shall determine all liability of this company under it. All payments under this policy shall reduce the amount of the insurance *pro tanto*. No payment or settlement can be demanded without producing this policy for indorsement of the fact of such payment or settlement. If this policy be lost, indemnity must be furnished to the satisfaction of this company.

8. Whenever this company shall have settled a claim under this policy, it shall be entitled to all the rights and remedies which the insured would have had against any other person or property in respect to such claim had this policy not been made, and the insured will transfer or cause to be transferred to this company such rights, and permit it to use the name of the insured for the recovery or defense thereof. If the payment does not cover the loss of the insured, this company shall be subrogated to such rights, in the proportion which said payment bears to the amount of said loss not covered by said payment. And the insured warrants that such right of subrogation shall vest in this company unaffected by any act of the insured.

9. Nothing contained in this policy shall be construed as a guarantee against the consequences of the exercise and enforcement or attempted enforcement of governmental "police power" over the property described herein.

10. No title or rights of the insured in any premises beyond the lines of the premises as described in Schedule "A" or in any streets, roads, avenues, lanes or ways on which the said premises abut, except the ordinary rights of light, air and access belonging to abutting owners are insured by this policy unless such rights

are specifically expressed as being insured, nor does this policy insure that the buildings or other erections upon the premises comply with State and Municipal laws, regulations and ordinances.

11. This policy does not insure the title to any personal property, whether the same be attached to or used in connection with said premises or otherwise.

12. CO-INSURANCE AND APPORTIONMENT PROVISIONS. If the premises described in Schedule A are subsequently improved or altered and the cost thereof exceeds 20 per centum of the amount insured hereunder, such proportion only of any loss established shall be borne by the Company as 120 per centum of the amount of this policy bears to the total value of the property as improved.

If the premises described in Schedule A are divisible into separate, independent parcels and a loss is established affecting one or more of said parcels, the loss shall be computed and settled on a pro rata basis as if this policy was divided pro rata as to value of said separate independent parcels, exclusive of improvements made subsequent to the date of the policy.

13. Defects and incumbrances arising after the date of this policy or created, suffered, assumed or agreed to by the insured, and taxes and assessments which have not become a lien up to the date of this policy or which are payable in future installments, are not to be deemed covered by it; and no approval of any transfer of this policy shall be deemed to make it cover any such defect, incumbrance, taxes, or assessments. The term "the insured" wherever it is used in this policy includes all described on its first page as those whom it insures; and the term "this company" wherever it is used in this policy, means the COMPANY.

SPECIMEN COPY OF MORTGAGEES' POLICY

POLICY No. PREMIUM \$.....

RATE, $\frac{1}{2}$ of 1% per annum.

THE COMPANY

NEW YORK CITY

The COMPANY, (hereinafter termed the "Company"), in consideration of the premium and terms of guarantee named below, hereby guarantees to

Address:

and to such legal representative, successors or assigns of the above as shall present to the Company satisfactory proof of ownership of this policy and of the bond and mortgage described in Schedule A, (all of whom are herein designated as "the assured").

First: Payment of interest at the rate of per cent. per annum, subject to such deduction for Income Tax as may be required by law, computed from 192

within five days after the same shall have become due under the terms of said bond and mortgage upon the amount of the principal sum hereby guaranteed at any time outstanding until said principal sum shall be wholly paid.

Second: Payment of the principal sum of

dollars

secured by said bond and mortgage as and when collected, but in any event within eighteen months after payment shall be demanded by the assured provided such demand be made after said principal sum shall have become due under the terms of the said bond and mortgage.

By the acceptance of this policy the Company is irrevocably appointed the exclusive agent of the assured at its own expense to sue for and receive the proceeds of any policy of Title Insurance and of any policy of Fire Insurance covering the mortgaged premises and to collect the interest on the bond and mortgage hereby guaranteed and to exercise every option or privilege in said bond and mortgage or either of them contained and given to the mortgagee; and the assured agrees until the breach or termination of this guarantee to refrain from exercising any such option or privilege

and from collecting any part of said interest or of the principal secured by said bond and mortgage except through the Company and to permit the Company to retain as its premium for this guarantee all interest collected in excess of the rate guaranteed above.

This policy is subject to the agreements, conditions and general provisions hereto annexed and to such others as may be endorsed hereon and signed by an officer of the Company, all of which are hereby made a part of this contract.

In witness whereof, the corporate seal of the said Company is hereunto affixed this day of in the year one thousand nine hundred and

.....
Vice-President.

.....
Assistant Secretary,

AGREEMENTS

THE COMPANY UNDERTAKES AND AGREES:

First: To institute and conduct as and when it may deem expedient but without expense to the assured all such proceedings as may be necessary to enforce payment of said Bond and Mortgage or the fulfillment of the other covenants and agreements contained therein.

Second: To keep the *Title* to the mortgaged premises guaranteed to the amount of this policy during the life hereof.

Third: To keep the mortgaged premises adequately insured against *Fire* and to require the owner thereof to pay all such *Taxes, Assessments* and *Water Rates* and all such fire insurance premiums as by the terms of the mortgage are required to be paid.

CONDITIONS

THE ASSURED UNDERTAKES AND AGREES:

First: To notify the Company promptly in writing of any assignment of said bond and mortgage and of any action or proceeding of which the assured has knowledge affecting said bond and mortgage.

Second: To forward to the Company promptly any and all notices relating to any policy of fire insurance affecting the mortgaged premises.

Third: To permit the Company, and the Company is hereby authorized without further action by the assured, at any time when said bond and mortgage shall become due, either by the terms thereof or by reason of the exercise of any option given therein to the mortgagee, to enforce payment of the same in the name of the assured, by its own agents and attorneys but without expense to the assured either by foreclosure or otherwise; and on notice from the Company to produce and deposit with it for that purpose the bond and mortgage, all securities collateral thereto and all muniments of title relative thereto held by the assured, and to execute and verify such proofs and pleadings as may be required by the Company in the course of such proceedings, and out of the proceeds of such action to permit the Company to receive so much as may remain after paying to the assured whatever may be due the assured for principal and interest at the rate hereby guaranteed.

Fourth: To permit the Company to buy in the property covered by said bond and mortgage and to take title thereto in the name of the assured, in case at any sale of said property in any foreclosure suit brought by the Company no bid shall be received for said property sufficient to cover the amount of the judgment and the expenses of the sale. In case the said property shall be so purchased by the Company in the name of the assured, the Company shall be entitled, upon paying the assured, or the executors, administrators, successors or assigns of the assured, within the time limited in the foregoing policy, the amount of the principal guaranteed by this policy, together with interest thereon at the rate hereby guaranteed (in so far as the same has not already been paid), to the conveyance of the said property to it or its nominee by the assured or the heirs, devisees, or successors of the assured free and clear of all claims, charges and liens thereon created by the assured since the purchase thereof upon the said foreclosure and to an assignment of the deficiency judgment entered in said foreclosure action. Until such payment or until the time shall have expired within which same may be made by the Company, the Company shall be entitled to the possession and management of the said property and to control the leasing, repairs and maintenance and insurance thereof at its own expense and to receive the rents and profits thereof, but at all times the liability of the Company under

this policy shall continue until the assured shall have received the full amount of the principal guaranteed hereby with interest thereon at the rate guaranteed hereby.

Fifth: To assign and deliver said bond and mortgage to the Company if requested to do so whenever the assured is entitled to require payment thereof, upon receipt from the Company of the full amount due the assured under this policy upon said bond and mortgage.

GENERAL PROVISIONS.

This policy may be assigned by the assured, by written assignment, to any person to whom the said bond and mortgage, or any interest therein, may have been transferred provided that the assignment of such bond and mortgage, or of such interest therein, shall also be in writing, duly acknowledged or proved according to law, and that, if not duly recorded, such assignment, or a duplicate or a certified copy thereof as the Company may require shall be deposited by the Company.

All notices or demands provided for in this policy shall be in writing and may be sent by mail.

The address of the assured to which notices shall be sent shall be deemed to be the address stated herein or such other address as may have been furnished by the assured to the Company in writing for this purpose.

All notices to or demands on the Company shall be sent to its principal office at....., New York.

SCHEDULE A.

The bond covered by this guarantee was made by
to

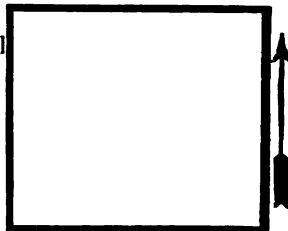
dated , and is marked for identification with the number of this guarantee and the signature of one of the officers of the Company.

It was given for the payment of		dollars
on the	day of	
with interest at the rate of		per cent.
per annum, payable on the		day of
and		in each year.

The mortgage given to secure said bond is similarly identified and was made by
to

, and recorded in the office of the
of the County of
on the day of

The location and description of the real
property covered by this guarantee
is shown by the annexed diagram:



The title to the said property is insured and said mortgage is a valid first lien on a good and marketable title in fee to the property therein described.

CHAPTER XXXI

CREDIT INSURANCE

Definition and Purpose.¹—Credit insurance has for its purpose the indemnification of losses, coming within the coverage of the policy and exceeding the normal loss of the business under consideration, suffered by manufacturers and jobbers through the insolvency of their customers. Retailers, it should be noted, are not protected under this form of insurance. It is essential to bear in mind that credit insurance does not insure against expected loss occurring in any business through bad debts, but covers only the unexpected losses, that is, those in excess of the “normal” or “average” loss.

Insurance of this type is used to-day by manufacturers and jobbers in every line of business, and irrespective of the volume of their sales. Where the trade happens to be extra hazardous—a situation prevailing in a limited number of cases like diamonds, jewelry, furs and patent medicines—the coverage is either not granted at all or is limited to the most substantial concerns.

The Need for Credit Insurance.—Every merchant concedes the necessity of carrying fire insurance on his stock, yet the total sales of nearly every merchant each year—sales made chiefly on the basis of credit—exceed by many

¹For excellent discussions of credit insurance see the article on Credit Insurance in “Federal Reserve Bulletin,” issued by the Federal Reserve Board, June, 1922; and Chapter 22, on “Credit Insurance” in Riegel and Loman’s “Insurance Principles and Practices.” The author desires to give special acknowledgment to the article in the Federal Reserve Bulletin for many of the facts contained in this chapter.

times the value of his stock on hand. Statistics also show that annual failure losses in the United States exceed the average annual fire loss. The following table, comparing the annual fire loss with the loss through bad debts during the past ten years, makes an instructive showing:²

FAILURE AND FIRE LOSSES FOR 10 YEARS

	Failure Loss	Fire Loss
1921.....	\$750,200,000	\$332,654,950
1920.....	426,300,000	330,853,925
1919.....	115,500,000	269,000,775
1918.....	137,900,000	290,959,885
1917.....	166,600,000	250,752,640
1916.....	175,200,000	214,530,995
1915.....	284,100,000	172,033,200
1914.....	357,100,000	221,439,350
1913.....	292,300,000	203,763,550
1912.....	198,900,000	206,438,900
Total.....	\$2,904,100,000	\$2,492,428,170

The foregoing table shows clearly that losses through insolvency are not only very large, but vary greatly from the average, especially in years of financial panic or business depression. For the ten-year period under consideration the aggregate insolvency loss exceeded the fire loss by \$411,671,830, or on an average by over \$41,000,000 per year. But notice should also be taken of the high failure losses recorded for 1914, 1920, and 1921, years of financial stringency or business depression. During those years failure losses exceeded 357 millions, 426 millions, and 750 millions, respectively, or \$1,533,000,000 for the three years. This total is equal to nearly 53 per cent of the total loss

² Federal Reserve Bulletin, June, 1922, p. 667.

recorded for the entire decade, and exceeds the fire loss for the same three years by 649 millions, or by over 73 per cent. In fact, our more or less periodic business depressions produce an effect with respect to insolvency losses and credit insurance similar to the effect of large conflagrations in the field of fire insurance. This is shown by the following table, indicating the growth of credit insurance and giving the premium receipts and paid losses for each of the past ten years: ³

COMBINED EXPERIENCE OF THE AMERICAN CREDIT-INDEMNITY COMPANY, THE LONDON GUARANTEE AND ACCIDENT COMPANY, AND THE OCEAN ACCIDENT GUARANTEE CORPORATION FOR THE TEN YEARS, 1912-1921

Year	Premiums	Losses	Per Cent
1912	\$1,611,352	\$1,195,840	74
1913	1,506,827	923,293	61
1914	1,487,506	732,139	49
1915	1,395,713	939,765	67
1916	1,413,566	293,423	21
1917	1,665,915	97,076	6
1918	1,856,703	194,182	10
1919	2,219,679	72,552	3
1920	3,695,954	637,318	17
1921	3,498,161	3,100,782	89

The foregoing table shows how greatly losses vary from year to year. During the decade the variation ranged from 3 per cent, 6 per cent, and 17 per cent of the premiums in 1919, 1917 and 1920, respectively, to 67 per cent, 74 per cent, and 89 per cent of the premiums in the years 1915, 1912 and 1921. As a general proposition, losses vary according to business conditions, although the highest vol-

³ Federal Reserve Bulletin, p. 676.

ume of claims is usually recorded one or two years following the financial or commercial crisis.

A further analysis of commercial failures shows that a very substantial proportion of the loss is traceable to causes, such as disasters or failure of others, which can not be foreseen. Bradstreet's classification of business failures, by causes, in the United States during 1918 and 1919, shows the following:

CLASSIFICATION OF BUSINESS FAILURES BY CAUSES

(Pamphlet of the London Guarantee and Accident Company)

	Per Cent	
	1919	1918
A. DUE TO FAULTS OF THOSE FAILING:		
Incompetence (irrespective of other causes)...	38.2	36.5
Inexperience (without other incompetence)...	5.6	6.7
Lack of capital.....	30.3	33.2
Unwise credits.....	1.3	1.3
Speculation (outside regular business).....	0.7	0.4
Neglect of business (due to doubtful habits)...	1.7	1.5
Personal extravagance.....	1.1	0.6
Fraudulent disposition of property.....	7.0	5.8
B. NOT DUE TO FAULTS OF THOSE FAILING:		
Specific conditions (disaster, war, floods, etc.)...	11.3	11.9
Failures of others (of apparently solvent creditors).....	1.7	0.9
Competition.....	1.1	1.2
	100.0	100.0

Benefits Derived from Credit Insurance.—The foregoing data makes it clear that in the granting of credit to

purchasers by manufacturers and jobbers there is sufficient uncertainty in the loss from year to year, and a sufficient lack of control over the causes which underlie that loss, to make the granting of credit a fit subject for insurance. In promising indemnity for loss of credits, credit insurance benefits the insured by giving him:

(1) Substantial collateral on his merchandise accounts, thus enabling the extension of credit to reliable firms without fear of loss, especially since the coverage extends to any calamity that may befall his customers.

(2) A conservative guide in the extension of credit to customers by indicating through its policy restrictions the line of credit that may wisely be extended to different types of purchasers.

(3) An efficient collection and salvaging service, which, as will be explained later, aids greatly in the prevention of insolvency, or, in the event that insolvency has occurred, serves effectively to eliminate unnecessary loss.

Recent Development of the Business.—The real development of credit insurance is limited to the last twenty years, and particularly to the last ten. The American Credit-Indemnity Company of New York, devoting itself entirely to this form of insurance, was incorporated in 1893, while the other two companies—the Ocean Accident and Guarantee Corporation (Ltd.), and the London Guarantee and Accident Company (Ltd.)—established their American credit insurance departments in 1895 and 1905. Until comparatively recent years, the business was largely experimental, and policies were necessarily written on a very restricted basis. Owing to the absence of statistical data, the underwriting of risks was essentially a matter of individual judgment. Even as late as 1911 credit insurance had scarcely emerged out of the experimental stage and the author was advised that the companies lacked the

statistical data necessary to place a system of insurance upon a scientific basis.⁴

The table on page 527 shows an increase in premium income of the three aforementioned companies, during the last five years, of over 100 per cent, namely, from \$1,665,915 to \$3,498,161. In 1916 so-called "unlimited policies" were also written for the first time, while in 1922 the three companies adopted a Manual of Credit Insurance Rates. Adoption of this Manual probably constitutes the most important event of recent years in the field of credit insurance. The importance of the manual has been explained as follows:⁵

"This year the three companies completed the preparation of a manual, or mortality table, for underwriting against losses. It is the culmination of a long succession of mathematical calculations based on experience, which developed, step by step, the facts that yielded the charges necessary to furnish the protection. The records of the companies, covering a period of many years, reveal the private, precise, and full experience of thousands of wholesale merchants in every line of trade, including their sales to variously rated concerns and the losses thereon. From this information the Manual of Credit Insurance Rates was compiled.

There are three basic and interdependent factors in credit insurance underwriting, viz., (1) the premium; (2) the normal loss; and (3) the coverage, or insurance afforded on specified ratings. The premium and normal loss can not be determined until there is first ascertained the coverage of the policy on each of the ratings specified in the "table of ratings" given in the "coverage" clause of the policy. When these coverages are agreed upon, the premium and the normal loss are quickly and accurately determined.

⁴See S. S. Huebner: "Property Insurance" (1911), Chapter XXXI on "Credit Insurance," p. 375.

⁵Federal Reserve Bulletin, p. 672.

Prior to the perfection of the manual the underwriting was difficult and was largely a matter of judgment for the individual underwriter. Its adoption has rendered possible the training and development of agents on a large scale, and there has been a gradual increase in the agency force. Corresponding increase in the use of credit insurance is looked for."

Methods of Safeguarding the Company.—Credit insurance companies must restrict carefully the risk which they assume, because the giving of unlimited protection against loss through bad debts would greatly increase the recklessness with which credit would be granted. The object of credit insurance is to indemnify losses which cannot be foreseen and which are not brought about by the carelessness of the insured. To prevent recklessness on the part of the insured, all credit insurance policies contain three fundamental features, known respectively as "the normal loss," "coverage" and "coinsurance." All of these features have, as will be explained, an important bearing upon the extent of the company's liability.

The Normal Loss.—Every credit insurance policy provides that the insured must first himself bear the so-called "normal loss" before the company becomes liable for the excess. This normal loss represents the average annual expected loss which the business has experienced over a period of years. As shown by the application for credit insurance, this average or normal loss is determined by comparing the losses and amounts of accounts owing by debtors under general extension to the gross sales of the business for the last five years plus the fractional year to date. The normal loss, since it is expected to occur, may be viewed as a part of the cost of operating the business. It is not considered a fit subject for insurance, since it can ordinarily be shifted to the consumer as are other costs of operation. Moreover, by assuming normal losses

himself the insured has his cash premium greatly reduced. If expected losses are to be assumed by the insurance company, it would necessarily follow that the premium be increased by a corresponding amount. Such a plan would merely inject an unnecessary and undesirable speculative feature into credit insurance. The plan in actual use is preferable since it protects the insured against loss, in excess of his average loss, and allows him to retain any difference between his actual and normal loss should the former prove less than the latter.

In the policy the normal loss is expressed in the form of a percentage of the gross sales. To quote the wording: "From the aggregate net loss, ascertained in adjustment as hereinafter provided, there shall be deducted an agreed normal loss of per cent, to be borne by the indemnified, upon the total gross sales made during said term; but such normal loss so to be deducted shall be not less than \$.; and the remainder, if any, shall be the loss payable by the company."

The normal loss, it should be stated, varies considerably for different kinds of trades, and even differs for different firms in the same line of business. Conditions are seldom alike, and one type of business suffers much more from loss through bad debts than another. Again, in a given line of business, one firm may make its terms of sale very different from another. It may confine its sales to a particular territory, or may cater to the trade of a particular class, or its credit department may be liberal instead of conservative. Furthermore, the amount of normal loss provided for in the policy will increase as the sales of the business grow. Thus, if we assume the sales of a prospective applicant for credit insurance to equal \$200,000, and the normal loss arranged for in the policy to be one-half of 1 per cent of the sales, then

the insured must suffer a loss of \$1,000, after making any other deductions required by the policy, before the company can be called upon to pay any excess. In case, however, business conditions are prosperous and the sales for the year increase to \$300,000, the amount of normal loss, fixed at one-half of 1 per cent of the sales, will automatically increase to \$1,500. But, on the other hand, the normal loss is limited in the policy to a stipulated minimum, say \$1,000, and will not decrease if, because of poor business conditions, the sales fall below \$200,000. This is due to the well recognized fact that decreased sales are indicative of business conditions which tend to increase the danger of loss through bad collections.

According to a recent statement,⁶ normal losses vary at present from one-tenth of 1 per cent to 1½ per cent of the annual sales, depending upon the line of trade under consideration. The average normal loss is stated to be about three-tenths of 1 per cent, whereas "the average loss through insolvency for all merchants in the United States is estimated at about one-half of 1 per cent."

The Manual of Credit Insurance Rates, previously referred to, classifies different lines of trade into five groups, numbered from 1 to 5 and ranging from a low normal loss rate for group 1 to successively higher rates for the other groups. For each of the first four groups the Manual prescribes a basic normal loss (on the basis of annual sales) for all firms engaged in any line of business listed under each of these groups. Thus far some 287 lines of trade have been classified under the first four groups. For group 5, representing extra hazardous lines of trade, no rates have yet been compiled. The purpose of the classification, as explained,⁷ is "to

⁶ Federal Reserve Bulletin, p. 673.

⁷ Federal Reserve Bulletin, p. 673.

adjust rates to the normal for each house in each line of business, so that all lines shall thereby be made equally desirable for credit underwriting at the rates required."

Coverage.—Credit insurance companies also find it necessary to limit the amount recoverable for losses on any one account. In the absence of such a restriction, the insured might recklessly grant an unwarranted amount of credit to a single customer, and thus practically invite a heavy loss. To avoid this contingency the policy provides for the following coverage agreement:

"No loss is covered by this Bond, unless the debtor to whom the goods were shipped and delivered shall have in the latest published book of the Mercantile Agency, at the date of the shipment, a capital rating and its accompanying credit rating, as tabulated below.

The books of the said Mercantile Agency shall respectively govern shipments from the first day of the month named by said book to the first day of the month named by the next subsequent book, except that where the said Mercantile Agency increases or reduces a rating by report, compiled during the currency of the said latest published book or within thirty (30) days prior to the date thereof, shipments made after the Indemnified has received such report from the said Mercantile Agency shall be governed by the rating in such report, the same as if the said rating had appeared in the said latest published book.

The gross amount to be covered on any one debtor at the date of insolvency shall be limited to the amount set opposite the corresponding rating of the debtor in the subjoined "Table of Ratings":

(Here follows a large space for the tabulation of the capital and credit ratings of the Mercantile Agency used,

and the table of ratings indicating the gross amount to be covered on any one debtor.)

The aggregate gross amount covered on the accounts of any one debtor shall not exceed the amount owing by the debtor, nor exceed the limit applicable to such debtor as specified above.

The total amount covered on the indebtedness of a debtor having more than one governing rating shall be limited to the amount set opposite the debtor's highest governing rating, except that where the debtor's highest governing rating is reduced, shipments made thereafter shall not be covered so long as the debtor owes the amount set opposite the reduced governing rating in the "Table of Ratings." If, however, the debtor owes less than the said amount, the total amount covered on all governing ratings shall not exceed the limit set opposite the said reduced rating.

(NAMES NOT IN BOOK).—A shipment to a debtor, whose name does not appear in the said latest published book at the date of the shipment, shall be governed by the rating in the latest report of said Agency on such debtor compiled within four months prior to the shipment, and if no such report was compiled within four months prior to the shipment, then by the first report of said Agency on such debtor compiled within four months after the shipment. Every such governing rating shall have the same effect as if contained in said latest published book at the time of shipment."

By the above provision the insurance company only covers losses arising out of sales to customers who have a capital and credit rating in some designated mercantile agency, and definitely limits the coverage on any one account to the amount set opposite the corresponding rating of the debtor. The insured is given the option of naming in the application blank any well-known mercantile agency whose capital and credit ratings are to be used as govern-

ing the shipments covered by the policy.⁸ The agencies most generally used are Dun and Bradstreet. Since the ratings of these two mercantile agencies perform such a vital service in the granting of credit insurance, they are herewith presented:

R. G. DUN & Co.

Estimated Pecuniary Strength		General Credit			
		High	Good	Fair	Limited
AA	Over \$1,000,000	A1	1	1½	2
A+	\$750,000 to \$1,000,000	A1	1	1½	2
A	500,000 to 750,000	A1	1	1½	2
B+	300,000 to 500,000	1	1½	2	2½
B	200,000 to 300,000	1	1½	2	2½
C+	125,000 to 200,000	1	1½	2	2½
C	75,000 to 125,000	1½	2	2½	3
D+	50,000 to 75,000	1½	2	2½	3
D	35,000 to 50,000	1½	2	2½	3
E	20,000 to 35,000	2	2½	3	3½
F	10,000 to 20,000	2½	3	3½	4
G	5,000 to 10,000 . . . .	.....	3	3½	4
H	3,000 to 5,000 . . . .	.....	3	3½	4
J	2,000 to 3,000 . . . .	.....	3	3½	4
K	1,000 to 2,000 . . . .	.....	3	3½	4
L	500 to 1,000 . . . .	.....	.....	3½	4
M	Less than 500 . . . .	.....	.....	.....	.....

⁸ The article on Credit Insurance in the Federal Reserve Bulletin also mentions as acceptable the ratings of such well-known agencies, operating in special fields, as the Shoe & Leather Agency, Lyon Furniture Mercantile Agency, Lumbermen's Credit Association, National Lumber Manufacturers Credit Corporation (Red Book), National Jewelers Board of Trade, and Iron and Steel Board of Trade.

BRADSTREET

Estimated Wealth		Grades of Credit		
G	\$1,000,000 and above.....	AA	A	B
H	\$500,000 to \$1,000,000.....			
J	400,000 to 500,000.....	A	B	C
K	300,000 to 400,000.....			
L	250,000 to 300,000.....			
M	200,000 to 250,000.....			
N	150,000 to 200,000.....	B	C	D
O	100,000 to 150,000.....			
P	75,000 to 100,000.....			
Q	50,000 to 75,000.....			
R	35,000 to 50,000.....	C	D	E
S	20,000 to 35,000.....			
T	10,000 to 20,000.....			
U	5,000 to 10,000.....			
V	3,000 to 5,000.....	D	E	F
W	2,000 to 3,000.....			
X	1,000 to 2,000.....	E	F	
Y	500 to 1,000.....			
Z	0 to 500.....			

An examination of the above tables shows that for credit insurance purposes credit ratings are divided into classes, namely, "preferred" and "inferior." The shaded line in each table separates the two, the inferior ratings appearing to the right. Ordinarily, the policy applies only to such customers as have preferred ratings. Partial protection on inferior ratings, however, may be obtained upon the payment of an extra premium and the assumption by the insured of a larger share of any loss.

Reference should also be made to the "Table of Ratings," which specifies in dollars the limit of the company's liability attaching to each designated credit rating. As

shown by the following table, the coverages range all the way from \$400 to a maximum of \$100,000, depending upon the rating and the willingness of the company to meet the requirements of the insured. The limit allowed to any rating, however, is never permitted to exceed that granted to a higher rating. In practice the companies also decline to cover risks beyond certain maximum limits which they have adopted for the several ratings. Sometimes "maximum abnormal limits" are allowed, for an extra premium, in the case of first grades of credit.

MAXIMUM LIMITS FOR DUN RATINGS *

	First Credit Rating		Second Rating	
	Maximum Normal	Maximum Ab-Normal		
AA—A1.....	\$50,000	\$100,000	AA1.....	\$35,000
A+A1.....	40,000	75,000	A+1.....	30,000
A A1.....	40,000	60,000	A1.....	25,000
B+1.....	35,000	50,000	B+1½.....	20,000
B1.....	30,000	40,000	B1½.....	20,000
C+1.....	25,000	30,000	C+1½.....	15,000
C1½.....	18,750	25,000	C2.....	12,500
D+1½.....	12,500	20,000	D+2.....	10,000
D1½.....	8,750	15,000	D2.....	7,000
E2.....	5,000	8,000	E2½.....	4,000
F2½.....	2,500	4,000	F3.....	2,000
G3.....	1,250	2,000	G3½.....	1,000
H3.....	750	1,250	H3½.....	600
J3.....	500	800	J3½.....	400
K3.....	250	400		

* Federal Reserve Bulletin, p. 674.

Coinurance.—As regards preferred risks, it is the general practice to make the insured a coinsurer to the extent of 10 per cent of any loss, although sometimes a different percentage is used. Thus if the actual loss is \$2,000, the insured, under 10 per cent coinsurance, is required to bear \$200 of the loss himself. In some policies the 10 per cent is deducted from the “net loss,” whereas in others the deduction is made from the “gross loss.” On sales to inferior rated risks, the company’s liability is usually limited to only two-thirds of any loss, that is, there is coinsurance for $33\frac{1}{3}$ per cent. Briefly stated, the effects of coinsurance are three-fold, namely, (1) the premium charge is materially reduced; (2) the insured’s participation in all losses offsets in part at least the difference between the selling and the cost price of the goods, thus tending to make the insurance cover, on the average, only replacement value, instead of both cost and profit; and (3) the insured is much more likely to be conservative in the granting of credits, and any moral hazard in the form of unreasonable risks in the extension of credit is largely, if not entirely, eliminated.

Different Types of Policies.—Having explained the three fundamental features found in all forms of credit insurance policies, attention may next be directed to two important factors concerning which credit policies present vital differences. The factors referred to are (1) the size of the policy, and (2) the collection service. With respect to the first, policies are either “limited” or “unlimited.” With reference to the second, they are either “collection” or “noncollection” policies. Both of the last-named policies, it should be stated, may be written on either the limited or unlimited form. Collection policies, in turn, are either of the “optional collection” or “compulsory collection” type.

“Limited” and “unlimited” policies.—The limited

policy, to quote its wording, "guarantees against loss, to an amount not exceeding \$....., due to insolvency, etc." It thus limits the company's maximum liability with respect to the aggregate losses covered. Where the circumstances warrant, the amount of such liability, may, however, be raised, upon the payment of an additional rate per \$1,000 of protection, to a figure as high as \$200,000.

Unlimited policies contain no fixed face value, and, to quote their wording, "guarantee against loss due to insolvency, etc." The insured is, therefore, entitled to collect all losses on individual accounts, irrespective of the aggregate amount involved, so long as they do not exceed "the amount set opposite the corresponding rate of the debtor in the subjoined table of ratings." Such policies involve a higher premium charge than limited policies. They are particularly valuable as collateral, because, as explained.¹⁰

"They offer full protection on all outstanding accounts and are valuable as collateral with a bank, for the obvious reason that the face of a limited policy is seldom, if ever, as much as the amount of the unpaid outstanding accounts of the policyholders at any one time. For example, a limited policy of \$10,000 or \$25,000 would not be sufficient as collateral to a bank lending a merchant \$50,000 or more, where the unpaid outstanding accounts of the merchant are, say, \$100,000 or \$200,000 and perhaps more, for the outstandings, as heretofore stated, range from 15 to 25 per cent of the annual sales."

"Collection" and "noncollection" policies.—Under non-collection policies, accounts are handled and must be proved by the insured. Under collection policies, on the

¹⁰ Federal Reserve Bulletin, p. 669.

contrary, the company handles the collection of accounts and proves the claims. If the policy is of the "optional collection" kind, the insured has the privilege of electing whether or not he will file with the company any account due and payable. He may not, however, file any claim more than sixty days past due. Moreover, should a past due account not have been filed with the company, and the debtor becomes insolvent, the account must then be filed for collection. This type of policy, it should be noted, offers the insured the advantage of freeing him from risk and at the same time relieving him of the necessity of pressing his debtor by handing the account over to an insurance company for collection.

If the policy is of the "compulsory collection" variety, the insured is obliged, to quote the policy, "to file notification of claim and place the account against the debtor with the company for collection before the account is more than 75 days past due under the original terms of sale." Should this time be violated, the company is absolved from liability despite the fact that the debtor becomes insolvent. This form of policy protects all sales, made during the term of the contract, against losses covered by its provisions, whenever they may occur. The premium is, therefore, adjusted in accordance with the volume of sales, that is, the minimum advance premium is later increased in the event that the annual sales should exceed the original estimate. Under "optional" policies, on the contrary, the premium is a fixed amount.

As soon as an account is filed under either an optional or compulsory policy, the company undertakes its collection. By the terms of the policy the insured is required (1) to accompany each notification of claim filed with the company with "an itemized statement of the account showing fully the true condition thereof, together with all notes or other papers evidencing the

same, and any guarantees, securities, or other documents relating thereto"; (2) to furnish promptly upon request "duplicate invoices, proofs of debt, affidavits, or other documents, or any information necessary for the proper handling of any account in any proceeding"; and (3) to "authorize suit or other proceedings and promptly pay the necessary costs and expenses in connection therewith," should the account be in dispute or should the company "deem it necessary to enforce collection or to enable the insured to participate in any proceeding involving the estate of the debtor." All sums collected by the company, after deducting the collection fee stipulated in the policy, are paid to the insured. Any uncollected part is regarded by the company as a proved claim for loss. For its collection service the insured agrees to pay the company the following fees on collections effected:

"(1) Where the company effects collection without the services of an attorney:

Seven and one-half ($7\frac{1}{2}\%$) per cent of the first Three Hundred (\$300) Dollars or less.

Four (4%) per cent on the next Seven Hundred (\$700) Dollars.

Two (2%) per cent on the excess over One Thousand (\$1,000) Dollars.

Minimum fee Two Dollars and Fifty Cents (\$2.50), except, on collections under Five (\$5.00) Dollars, fee to be Fifty (50%) per cent.

(2) Where the Company deems it necessary to secure the services of an attorney:

Fifteen (15%) per cent of the first Three Hundred (\$300) Dollars or less.

Eight (8%) per cent on the next Seven Hundred (\$700) Dollars.

Four (4%) per cent on the excess over One Thousand (\$1,000) Dollars.

Minimum fee Five (\$5) Dollars, except, on collections under Ten (\$10.00) Dollars, fee to be Fifty (50%) per cent.

Minimum suit fee Seven Dollars and Fifty Cents (\$7.50) in addition to the fees, the whole not to exceed Fifty (50%) per cent of the claim.

In localities where collection fees or rates are established by law or by bar rules, such law or bar rules shall govern, or if the Commercial Law League of America shall adopt a higher or lower schedule of fees than hereinabove set forth, in schedule (2), such revised schedule so adopted, shall govern on all accounts filed with the Company thereafter.

When litigation or unusual proceedings are authorized by the Indemnified, a reasonable attorney's fee, in addition to the regular collection fee, will be charged."

Collection of accounts in credit insurance should be regarded as a salvaging service rather than a profit-making operation. In fire insurance more and more emphasis is placed upon "fire prevention," with a view to reducing the enormous annual waste. In employers' liability insurance, steam boiler insurance, corporate suretyship, and other forms of insurance, the companies aim to reduce losses to a minimum through a system of stringent supervision and inspection, and a very considerable part of their premium income is expended for this purpose. All appreciate that little good is accomplished by merely underwriting risks and paying losses as they occur. Insurance companies can render the business community an invaluable service by devoting their information and highly developed organization to the creation of ways and means that will reduce the sum-total of loss.

In conformity with general insurance practice, credit insurance companies now undertake to prevent loss through bad debts. Credit insurance should have for its

purpose not merely the payment of losses, but also the control of all accounts that have failed or are about to fail. Through its efficient organization the credit insurance company can handle insolvent accounts at a reduced cost. It is also to its interest to prevent the heavy loss so frequently resulting from bankruptcy sales by seeing that the stock of an insolvent concern is sold at the highest possible price. Its efficiency in handling past-due or otherwise doubtful accounts will also save many an embarrassed business from going under, and where the business fails, its prompt and intelligent action will certainly result in a reduction in loss as compared with the loss resulting from the disconcerted and often careless or ill-advised action of numerous creditors when acting individually. There can be little doubt that the collection service of credit insurance companies tends to lower the loss ratio, and to render collections more certain and less expensive.

Other Leading Policy Provisions.—*The application.*—The introductory portion of the policy declares that the company's guarantee is given "in consideration of the representations and warranties, made in the application for this bond and for any prior bond of indemnity issued to the indemnified by the company, which are hereby made a part of the contract, etc." The application referred to is on the reverse side of the policy and furnishes data with respect to the following:

The mercantile agency whose ratings shall govern the insured's shipments.

Nature of the insured's business.

Territory covered, or in which principal shipments are made.

Regular terms of sale, including the longest terms of sale.

Percentage of sales to manufacturers, to jobbers and to retailers.

Information detrimental to the credit of any party to whom sales have either been made or are contemplated.

Any material change in the manner of conducting the insured's business, either made during the past year or under contemplation.

Gross sales for the past five years, plus the fractional year to date.

All losses, and amounts of accounts owing by debtors under general extension, during the past five years, plus the fractional year to date. (For a specimen copy of the application see p. 552.)

Term and renewal of the policy.—Credit insurance policies guarantee against loss due to insolvency occurring “within the term beginning the day of 192.. and ending the day of 192.. and which loss shall result from the indemnified's bona fide sales of shipped and delivered during said term in the usual course of business to individuals, firms, etc.” Usually the policy runs for one year. Quite often, however, the insured will desire to have the policy period coincide with his fiscal year, which in most instances, is also the calendar year. Under such circumstances, the term of the policy may be longer than a year in order to make the date of expiration fall on December 31.

Policies of credit insurance are renewable annually, assuming that the company is willing to continue the insurance. Under such renewal the company's liability will be made to extend to losses occurring during the renewal period on sales effected during the preceding policy term. The company will, however, require the insured to furnish

a full warranted statement of all outstanding accounts on the date of renewal, including, among other information, an itemized record of the amount of such accounts (1) past-due, (2) under general extension, (3) seeking extension, and (4) in the hands of attorneys or collection agencies.

Definition of insolvency.—To quote its terms, the policy guarantees “against loss due to insolvency, as hereinafter defined.” The definition referred to has been largely standardized, and reads as follows in the optional collection form:

INSOLVENCY DEFINED

The Insolvency of a debtor for the purpose of this Bond shall be deemed to have occurred when, during the term of this Bond:

(1) The Indemnified elects to file with the Company for collection an account which, under the original terms of sale, is due and payable at the time of filing, but not over sixty (60) days past due under the said terms of sale;

(2) A petition in bankruptcy or insolvency is filed by or against a debtor under the laws of the United States, or any State or Territory thereof, or of Canada;

(3) A debtor makes an offer of a general compromise to his creditors for less than his indebtedness;

(4) A receiver is appointed for a debtor;

(5) A sole debtor dies or becomes insane;

(6) There is the recording of or taking possession under a chattel mortgage given by a debtor on his stock in trade to a creditor or creditors;

(7) An attachment or execution is levied on a debtor's stock in trade;

(8) A writ of execution against a debtor is returned unsatisfied;

(9) A debtor transfers or sells out his stock in trade in bulk;

(10) A debtor absconds;

(11) A debtor makes an assignment, or a deed of trust, for the benefit of his creditors, either general or with preferences;

(12) The stock in trade of a debtor is sold under a writ of attachment or execution;

(13) A confession of judgment is made by a debtor;

(14) A debtor's business is assigned to or taken over by a Committee appointed by a majority in number and amount of his creditors;

Provided that the Indemnified has not taken any action, in respect of the account, either prior to, or subsequent to, the date filed with the Company, which would operate in any manner against its prompt collection or the exercise of the Company's judgment upon any proposal made by the debtor to his creditors unless the Company's consent thereto in writing is first obtained.

Under noncollection policies notice of claim on insolvent accounts must be filed "within 20 days after the indemnified shall have received information of such insolvency" and final proof must be filed within 30 days after the policy's expiration. With respect to collection policies, the insured must file notice of claim "within 15 days after acquiring knowledge of the debtor's insolvency under subdivisions (2) to (14), inclusive, of the definition of insolvency." Further provision is made, and the same stipulation is also found in the noncollection policy, that "if information of any debtor's insolvency shall be received too late to enable the indemnified to notify the company during the term of the bond, then notification of such insolvency filed with the company within 20 days after the expiration of this bond shall be sufficient."

Method of adjustment.—The policy outlines in tabular form the method of ascertaining the net loss in any adjustment. Quoting the wording of the policy, the method is as follows:

Deduct from each gross loss covered and proven under the bond :

- (1) All discounts to which the debtor would have been entitled had the debt been paid at the date of insolvency.
- (2) All amounts collected thereon and all amounts which may have been obtained from any other source.
- (3) The amount of goods returned or replevined, when such goods are in the undisputed possession of the indemnified.
- (4) All amounts mutually agreed upon as thereafter obtainable.

From the aggregate net loss thus ascertained deduct :

- (1) 10 per cent coinsurance.
- (2) The agreed normal loss.

The balance is the amount due the indemnified.¹¹

For a nominal extra premium, all the companies make interim adjustments. This privilege is usually extended by attaching to the bond a so-called "interim adjustment of claims rider." Subject to various conditions, this rider gives the insured the privilege of receiving adjustments from time to time prior to the final adjustment.

Collateral benefits.—The policy is declared to be non-negotiable, but upon request of the insured the company will agree that any excess loss, becoming due and payable under the policy, shall be paid to any bank or trust com-

¹¹ The policy also contains provisions governing adjustments of loss in the event that (1) no mutually satisfactory arrangement can be reached as to the amounts obtainable on any loss; (2) the indebtedness of the debtor at the time of insolvency is not fully covered in the bond, thus involving the necessity of making all deductions on a pro rata basis; and (3) any covered and proven account of the indemnified against the debtor is disputed, in whole or in part. For these provisions see p. 559.

pany designated by, and for the account of the insured. The privilege is customarily extended by endorsing the policy with a so-called "collateral benefit rider."

Termination.—Most policies provide that: "If between the beginning of this Bond and the last day permitted for filing accounts under this Bond, both days inclusive, the Indemnified shall become insolvent, or shall cease to continue the business described in the said application for this Bond, as heretofore carried on, or shall go into liquidation, or shall seek a general extension from his creditors, or being a partnership shall be dissolved, then this Bond shall immediately terminate, and if any claim for excess loss is made a Final Statement of Claim shall be filed by the Indemnified, and an adjustment shall be made with the Indemnified in the same manner as if this Bond had originally by its terms been made to expire at the date of such termination. Temporary interruption by fire or by strike, or the death or withdrawal or admission of a member of a partnership, composed of more than two members, shall not be considered a discontinuance or dissolution." Some policies, while containing the above termination clause, also stipulate that either party to the contract shall have the right to terminate the same by giving 10 days' written notice with a proper adjustment of the premium.

Special Endorsements.—Mention has already been made of the "interim adjustment of claims" and "collateral benefit" riders. Various other riders, however, are used. The most important of these are:

(1) "Antedating rider," whereby the term of the bond is antedated to some agreed date.

(2) "Consignment rider," extending the coverage of the bond to losses occurring through the insolvency of debtors on shipments of merchandise on consignment, provided the consignment agreement between the indemnified and debtor

shall be legally enforceable against third parties as well as such debtor.

(3) "Guarantor rider," providing that if the indemnified makes sales to a debtor whose account is secured by a written guaranty, valid and legally binding at the time of insolvency, the rating of the guarantor at date of shipment shall be used as the basis of coverage on such account under the bond.

(4) "Limited inferior rating rider," providing that there shall be added to the table of ratings in the bond various inferior ratings, indicated in the rider, with the gross amount to be covered on any one solvent debtor at the date of insolvency under the bond set opposite each rating.

(5) "Special limited $66\frac{2}{3}$ per cent inferior rating coverage," limiting the company's liability on all such ratings, as enumerated in the rider, to two-thirds of the debtor's indebtedness at the date of insolvency.

(6) "Freight rider," stipulating that the basis of sales under the attached bond should be computed at invoice price of merchandise F. O. B. at shipping point, and the freight charges shall not be considered as any part of such transaction.

(7) "Conditional back sales rider," extending the coverage to losses on sales made during a stated period preceding the policy period.

(8) "Goods in process rider," applying the coverage to cases where the indemnified accepts a written order entailing the purchase of special material and the manufacture of goods not usually kept in stock, and such goods shall have been manufactured, or partially manufactured, during the term of the bond, for the purpose of filling the order, but shall not have been delivered at the date of the debtor's insolvency.

(9) "Conditional railroad rider," whereby bona fide sales of supplies and material to steam railroad companies,

of three hundred miles or more, shall for the purpose of establishing a rating under the bond be deemed and treated the same as though such railroads were engaged in mercantile pursuits, subject to the method of credit rating prescribed in the rider.

The Premium.—Reference to the premium was purposely deferred to the last, because its determination depends upon practically all of the important factors discussed in this chapter, namely, the normal loss, the coverage, the amount of coinsurance, the type of policy, the term of the policy, and the use of special endorsements. We are advised¹² that “the premium usually ranges from one-tenth to one-fourth of 1 per cent of the sales volume where the latter is small, and from one-twentieth to one-tenth of 1 per cent where it is large. The Premium, on the whole, averages about one-tenth of 1 per cent of the annual sales.”

Since the perfection of the Manual of Credit Insurance Rates, credit insurance rates are being more and more determined on an actuarial basis.¹³ Companies are also furnishing their agents with a manual of premium and normal loss estimates, confidential in character, so that they may be enabled to quote quickly an estimate on premium and normal loss for specified coverage. But these estimates must be regarded as such. The nature of credit insurance is such that each risk must be analyzed and the premium and normal loss adjusted to meet the conditions surrounding each individual case.

¹² Federal Reserve Bulletin, June, 1922, p. 672.

¹³ Several of the actuarial bases for such rates are discussed in the Federal Reserve Bulletin, previously referred to, pp. 672–673.

SPECIMEN OF APPLICATION IN CREDIT INSURANCE

(Printed on reverse side of policy)

We, the undersigned, hereby make application to THE AMERICAN CREDIT-INDEMNITY COMPANY OF NEW YORK, for a Bond of Indemnity to the amount of \$.; said bond, if issued, to be on the within form, the terms, conditions and stipulations whereof are agreed to by us. We herewith tender our check for \$. to the order of said Company in payment of the premium on said Bond.

We agree that the ratings of the. Mercantile Agency shall govern exclusively shipments under said Bond: We have been subscribers to said Mercantile Agency during the past years.

Our answers to the following questions are true:

1. What is your line of business?
How long in it? years.
2. Are you Jobbers or Manufacturers?
3. What territory do you cover?
4. To what territory do you make your principal shipments?
.
5. What are your regular terms of sale? per cent.
. days, net days.
What are your longest terms of sale, including dating?
6. About what percentage of sales to Manufacturers?
Jobbers? Retailers?
7. Have you any information detrimental to the credit or responsibility of any individual, firm, co-partnership or corporation to whom you have made a sale or shipment, or contemplate making any sale or shipment, to which said Bond, if issued, will apply?
.
8. Have you within the past year made, or do you contemplate making, any material change in the manner of conducting your business, terms of sale or territory mentioned above, or proportion of sales to Manufacturers, Jobbers or Retailers?
.

As a basis of the Bond hereby applied for, and of any Bond which may hereafter be issued to us, we warrant the following statement of our gross sales, losses, and amounts of accounts owing by debtors under general extension, to be correct:

TERM During the Year Ending:	GROSS SALES	ALL LOSSES (After deduct- ing only actual cash recoveries from debtors to date)	AMOUNTS OF ACCOUNTS owing by deb- tors under General Exten- sion
.....19...	\$.....	\$.....	\$.....
.....19...	\$.....	\$.....	\$.....
.....19...	\$.....	\$.....	\$.....
.....19...	\$.....	\$.....	\$.....
.....19...	\$.....	\$.....	\$.....
During the Frac- tional Year to Date.	\$.....	\$.....	\$.....

This application and said Bond, if issued, shall, with the within Conditions and Stipulations, constitute the entire agreement between the undersigned and The American Credit-Indemnity Company of New York, any verbal or written statement, promise or agreement, by any Agent of the said Company to the contrary notwithstanding. It is also agreed that this application, whether as respects anything contained therein or omitted therefrom, has been made, prepared and written by the applicant, or by his own proper agent.

Dated at.....this.....day of.....19...

WITNESS: Signature of applicant.....
.....

Address.....

SPECIMEN COPY OF "UNLIMITED" "OPTIONAL
COLLECTION" CREDIT INSURANCE POLICY

THE AMERICAN CREDIT-INDEMNITY COMPANY
OF NEW YORK

(Hereinafter called the Company)

In Consideration of the representations and warranties, made in the application for this Bond and for any prior Bond of Indemnity issued to the Indemnified by the Company, which are hereby made a part of this Contract, and upon payment of..... Dollars premium,

Hereby Guarantees, under the Conditions and subject to the Stipulations set forth on the within pages,....., of....., engaged in the business of....., against loss due to insolvency, as hereinafter defined, of debtors, which insolvency shall occur within the term beginning the..... day of.....192... and ending the..... day of.....192... and which loss shall result from the Indemnified's bona fide sales of..... shipped and delivered during said term in the usual course of business to individuals, firms, co-partnerships or corporations, in the United States of America, or any Territory thereof, and in the Dominion of Canada; and which loss is covered, proven and allowed, as is hereinafter stipulated. From the aggregate net loss, ascertained in adjustment as hereinafter provided, there shall be deducted first, ten per cent. (10%) thereof as co-insurance, and from the remainder an agreed Normal Loss of..... per cent., to be borne by the Indemnified, upon the total gross sales made during said term; but such Normal Loss so to be deducted shall not be less than \$.....; and the remainder, if any, shall be the loss payable by the Company.

This Bond does not cover any loss occurring prior to the payment of the premium therefor, although the Bond may have been delivered, nor any loss occurring after its expiration, nor any loss that is not a valid indebtedness against the debtor.

The Conditions and Stipulations on the within pages are a part of this Contract.

In witness whereof, THE AMERICAN CREDIT-INDEMNITY COMPANY of New York has caused its Corporate Seal to be hereto affixed and this Bond to be signed by its President and Secretary, in the City of New York, this.....day of.....192..

.....
Secretary.

.....
President.

CONDITIONS AND STIPULATIONS

1—**COVERAGE**—No loss is covered by this Bond, unless the debtor to whom the goods were shipped and delivered shall have in the latest published book of the.....Mercantile Agency, at the date of the shipment, a capital rating and its accompanying credit rating, as tabulated below.

The books of the said Mercantile Agency shall respectively govern shipments from the first day of the month named by said book to the first day of the month named by the next subsequent book, except that where the said Mercantile Agency increases or reduces a rating by report, compiled during the currency of the said latest published book or within thirty (30) days prior to the date thereof, shipments made after the Indemnified has received such report from the said Mercantile Agency shall be governed by the rating in such report, the same as if the said rating had appeared in the said latest published book.

The gross amount to be covered on any one debtor at the date of insolvency shall be limited to the amount set opposite the corresponding rating of the debtor in the subjoined "Table of Ratings":

(A considerable space is here reserved)

The aggregate gross amount covered on the accounts of any one debtor shall not exceed the amount owing by the debtor, nor exceed the limit applicable to such debtor as specified above.

The total amount covered on the indebtedness of a debtor having more than one governing rating shall be limited to the amount set opposite the debtor's highest governing rating, except that where the debtor's highest governing rating is reduced, shipments made thereafter shall not be covered so long as the debtor owes the amount set opposite the reduced governing rating in the "Table of Ratings." If, however, the debtor owes less than the said

amount, the total amount covered on all governing ratings shall not exceed the limit set opposite the said reduced rating.

(*Names Not in Book*)—A shipment to a debtor, whose name does not appear in the said latest published book at the date of the shipment, shall be governed by the rating in the latest report of said Agency on such debtor compiled within four months prior to the shipment, and if no such report was compiled within four months prior to the shipment, then by the first report of said Agency on such debtor compiled within four months after the shipment. Every such governing rating shall have the same effect as if contained in said latest published book at the time of shipment.

2—**INSOLVENCY DEFINED**—The Insolvency of a debtor for the purposes of this Bond shall be deemed to have occurred when, during the term of this Bond:

(1) The Indemnified elects to file with the Company for collection an account which, under the original terms of sale, is due and payable at the time of filing, but not over sixty (60) days past due under the said terms of sale;

(2) A petition in bankruptcy or insolvency is filed by or against a debtor under the laws of the United States, or any State or Territory thereof, or of Canada;

(3) A debtor makes an offer of a general compromise to his creditors for less than his indebtedness;

(4) A receiver is appointed for a debtor;

(5) A sole debtor dies or becomes insane;

(6) There is the recording of or taking possession under a chattel mortgage given by a debtor on his stock in trade to a creditor or creditors;

(7) An attachment or execution is levied on a debtor's stock in trade;

(8) A writ of execution against a debtor is returned unsatisfied;

(9) A debtor transfers or sells out his stock in trade in bulk;

(10) A debtor absconds;

(11) A debtor makes an assignment, or a deed of trust, for the benefit of his creditors, either general or with preferences;

(12) The stock in trade of a debtor is sold under a writ of attachment or execution;

(13) A confession of judgment is made by a debtor;

(14) A debtor's business is assigned to or taken over by a Committee appointed by a majority in number and amount of his creditors;

Provided that the Indemnified has not taken any action, in respect of the account, either prior to, or subsequent to, the date when filed with the Company, which would operate in any manner against its prompt collection or the exercise of the Company's judgment upon any proposal made by the debtor to his creditors unless the Company's consent thereto in writing is first obtained.

3—NOTIFICATION OF CLAIM:

When an account is placed with the Company for collection during the term of this Bond under Subdivision (1) of Condition 2 of this Bond, the Indemnified shall file with said account a Notification of Claim on the form prescribed by the Company.

During the term of this Bond, and within fifteen (15) days after acquiring knowledge of the debtor's insolvency under Subdivisions (2) to (14), inclusive, of Condition 2 of this Bond, the Indemnified shall file Notification of Claim and forthwith place the account against such debtor with the Company for collection.

But if information of any debtor's insolvency shall be received too late to enable the Indemnified to notify the Company during the term of this Bond, then notification of such insolvency filed with the Company within twenty (20) days after the expiration of this Bond shall be sufficient.

All accounts for collection and all Notifications of Claim shall be filed with the Company at.....

.....
The Company will supply the blank forms for filing Notification of Claim.

All claims filed with the Company shall be handled upon the terms as provided in Condition 4 of this Bond.

4—COLLECTION OF ACCOUNTS AND SCHEDULE OF FEES—Each Notification of Claim filed with the Company in accordance with the terms of Condition 3 shall be accompanied by an itemized statement of the account, showing fully the true condition thereof, together with all notes or other papers evidencing the same, and any guarantees, securities, or other documents relating thereto; and the Indemnified shall upon request, promptly furnish duplicate invoices, proofs of debt, affidavits, or any other documents, or any information necessary for the proper handling of any account in any proceeding.

Where an account is disputed, in whole or in part, or where the Company deems it necessary to enforce collection or to enable the Indemnified to participate in any proceeding involving the

estate of the debtor, the Indemnified shall authorize suit or other proceedings, and shall promptly pay the necessary costs and expense in connection therewith.

If any payment or return of merchandise is made by the debtor direct to the Indemnified, or if the account is withdrawn by the Indemnified, the costs and fees as herein provided shall be paid to the Company by the Indemnified, the same as if collection had been effected.

The receipt, retention or the handling by the Company of any account filed by the Indemnified under this Bond shall not constitute a waiver of any of the terms, conditions or stipulations of this Bond.

The Company assumes all responsibility for moneys collected by its agents and correspondents in the United States, or any Territory thereof, and Canada, and will promptly remit all amounts due the Indemnified as collections are made.

On each account filed with the Company under Condition 3 of this Bond, the Indemnified shall pay to the Company the following fees on collections effected:

(1) *Where the Company effects collection without the services of an attorney:*

Seven and one-half (7½%) per cent. of the first Three Hundred (\$300) Dollars or less.

Four (4%) per cent. on the next Seven Hundred (\$700) Dollars.

Two (2%) per cent. on the excess over One Thousand (\$1,000) Dollars.

Minimum fee Two Dollars and Fifty Cents (\$2.50), except, on collections under Five (\$5.00) Dollars, fee to be Fifty (50%) per cent.

(2) *Where the Company deems it necessary to secure the services of an attorney:*

Fifteen (15%) per cent. of the first Three Hundred (\$300) Dollars or less.

Eight (8%) per cent. on the next Seven Hundred (\$700) Dollars.

Four (4%) per cent. on the excess over One Thousand (\$1,000) Dollars.

Minimum fee Five (\$5) Dollars, except, on collections under Ten (\$10.00) Dollars, fee to be Fifty (50%) per cent.

Minimum suit fee Seven Dollars and Fifty Cents (\$7.50) in addition to the fees, the whole not to exceed Fifty (50%) per cent. of the claim.

In localities where collection fees or rates are established by law or by bar rules, such law or bar rules shall govern, or if the Commercial Law League of America shall adopt a higher or lower schedule of fees than hereinabove set forth, in schedule (2), such revised schedule so adopted, shall govern on all accounts filed with the Company thereafter.

When litigation or unusual proceedings are authorized by the Indemnified, a reasonable attorney's fee, in addition to the regular collection fee, will be charged.

5—FINAL STATEMENT OF CLAIM—If any claim for excess loss is made under this Bond, a Final Statement of Claim, duly sworn to, shall be made by the Indemnified upon blank forms which will be furnished by the Company upon application, and such Final Statement must be received by the Company at its Central Office in Saint Louis, Missouri, within thirty (30) days after the expiration of this Bond, otherwise there shall be no liability upon the part of the Company under this Bond.

No Claim for loss shall be made or allowed under this Bond unless set forth in such Final Statement of Claim.

6—METHOD OF ADJUSTMENT—To ascertain the net loss in any adjustment under this Bond, there shall be deducted from each gross loss covered and proven under this Bond:

(1) All discounts to which the debtor would have been entitled had the debt been paid at the date of insolvency;

(2) All amounts collected thereon and all amounts which may have been obtained from any other source;

(3) The amount of goods returned or replevined, when such goods are in the undisputed possession of the Indemnified;

(4) All amounts mutually agreed upon as thereafter obtainable.

If no mutually satisfactory agreement is reached as to the amounts thereafter obtainable on any loss, the Company shall allow the unpaid part of such loss, so far as covered. The Indemnified shall assign to the Company all accounts admitted in adjustment, together with all securities and guarantees relating thereto, except those accounts upon which the amount thereafter obtainable is mutually agreed upon.

If the indebtedness of the debtor to the Indemnified at the time of the insolvency is not covered in full by this Bond, then said deductions shall be made pro rata, viz.: in the ratio which the amount covered bears to the whole of such indebtedness. In such a case such assigned account shall be handled by the Company for the joint account of the Indemnified and the Company as their interest may appear.

From the aggregate amount of the net covered and proven losses thus ascertained, there shall be deducted; (first), ten per cent. (10%) thereof, as co-insurance; (second), the agreed Normal Loss; and the balance, if any, shall be the amount due the Indemnified. If the net amounts realized by the Company on the accounts assigned to it, as above provided, shall in the aggregate exceed the sum paid to the Indemnified, the Company shall refund the net excess.

The adjustment shall be made within sixty (60) days after the receipt by the Company of such Final Statement and the amount, if any, then ascertained to be due the Indemnified, shall at once become payable.

If any covered and proven account of the Indemnified against a debtor is disputed, in whole or in part, the same shall not be admitted in any adjustment until after it has been ascertained to be sustainable against the debtor.

7—COLLATERAL BENEFITS—This Bond is not negotiable but the Company will, upon written request of the Indemnified, provide that any excess loss that may become due and payable under its terms, conditions and stipulations, shall be paid to any Bank or Trust Company designated by and for account of the Indemnified.

8—TERMINATION—If, during the term of this Bond, the Indemnified shall become insolvent, as defined in any one or more of Subdivisions (2) to (14) inclusive of Condition 2 of this Bond except Subdivisions (7) and (13), or shall cease to continue the business described in the said application for this Bond, as heretofore carried on, or shall go into liquidation, or shall seek a general extension from his creditors, or being a partnership shall be dissolved, then this Bond shall immediately terminate, and if any claim for excess loss is made a Final Statement of Claim shall be filed by the Indemnified in the same manner as provided for in Condition 5 of this Bond and be received by the Company within thirty (30) days after such termination, and an adjustment shall

be made with the Indemnified within sixty (60) days after the receipt by the Company of such Final Statement in the same manner as if this Bond had originally by its terms been made to expire at the date of such termination. Temporary interruption by fire or by strike, or the death or withdrawal or admission of a member of a partnership composed of more than two members, shall not be considered a discontinuance or dissolution.

9—GENERAL PROVISIONS—The premium for this Bond shall be paid by check to the order of The American Credit-Indemnity Company of New York.

The Company will acknowledge the receipt of all Notifications of Claim and the Final Statement of Claim, but neither the acknowledgment nor the retention thereof by the Company, nor its failure to acknowledge receipt, shall be deemed an admission of liability or a waiver by the Company of any of the terms, conditions or stipulations of this Bond.

The representations and warranties made in the application of the Indemnified are the basis of, and a part of, this Bond. Misrepresentation, concealment or fraud in obtaining this Bond or any Bond of Indemnity heretofore issued by the Company to the Indemnified, or in any Notification of Claim or Statement of Claim filed under this or such other Bond, or in the proof or adjustment of any claim for loss under this or such other Bond, shall void this Bond from its beginning and the premium paid shall be forfeited to the Company. The Indemnified shall permit the Company at any reasonable time to examine and take extracts from the books, securities and papers of the Indemnified bearing upon any matter involved in any Notification of Claim or Statement of Claim filed under this Bond, or in any adjustment under this Bond, or upon any representation or warranty made in the application for this Bond or any prior Bond of Indemnity issued by the Company to the Indemnified, or upon any claim made either by the Indemnified or by the Company under this Bond, and in that connection shall give such assistance and information as the Company requires.

The rendering of any estimate or statement or the making of any settlement shall not bar the examination herein provided for, nor the Company's right to a refund of any amount overpaid the Indemnified in any adjustment by the Company.

No Agent is authorized to make any alteration in, or addition to, this Bond; and no addition to, or alteration in, this Bond shall be valid unless signed by the President of the Company.

All terms, conditions and stipulations of this Bond are to be deemed conditions precedent to any claim by the Indemnified.

No suit or action on this Bond shall be brought or be sustainable until after the compliance by the Indemnified with the terms, conditions and stipulations of this Bond, nor, in the absence of any statutory provision to the contrary, unless commenced within twelve (12) months after its expiration.

CHAPTER XXXII

MISCELLANEOUS FORMS OF PROPERTY INSURANCE

Combined Importance of Such Forms.—Twelve special kinds of insurance, protecting against loss of or damage to property, are worthy of a brief review. Most of these forms of insurance are written by fire or fire-marine companies; some are written only by casualty companies; while a few are transacted by both types of companies. Latest figures indicate that the aggregate annual premium income in the United States, derived from nine of these types of insurance, amounts to almost \$94,000,000. If data were available for all, there is reason to believe that this total would equal, if not exceed, \$100,000,000. Briefly described, the forms of insurance referred to are:

Burglarly and Theft Insurance.—Forty-two companies write this form of insurance, and collected for the year 1920, \$20,902,117 in premiums. Policies are either of the "residence" or "commercial" type, and the latter may, in turn, assume any one of four forms, namely, "mercantile open stock," "mercantile safe," "messenger robbery," and "bank burglary."

Residence burglary, larceny and theft policies, comprising about 50 per cent of the total business, protect the insured, to the extent defined in the contract, against loss (1) "by burglary, larceny, or theft of property of the insured as defined in the schedule from within the premises, committed by any person whose property is not covered hereunder"; and (2) "by damage, except by fire to the

said property and to the said premises, caused by any such person while in or upon the premises with the intent to commit burglary, larceny or theft." No liability, however, is assumed for any loss: (1) of money or securities in excess of \$50; (2) occurring subsequent to the date of any chattel mortgage, bill of sale, assignment, or change of interest in any of the insured property; (3) of property in excess of the cost of replacement at the time of loss; (4) from, contributed to by, or occurring during, a fire in the building in which the premises are located; (5) from, or contributed to by, any invasion or war, or for damage caused by water or the action of the elements; (6) from, contributed to by, or occurring during any explosion, except when caused by burglars; (7) if the risk is so changed as to materially increase the hazard without the company's knowledge, or if, the insured defrauds or attempts to defraud the company; (8) from any porch, veranda or piazza, and (9) of any property separately valued in or covered by any other policy. Within any policy year vacancy of the premises for four months is permitted, although by endorsement and upon payment of additional premium this period of vacancy may be extended.

The insured property is described and valued under three groups. Group "A" comprises jewelry, silverware and furs; group "B," all other household goods common in residences; and group "C," articles separately and specifically described and insured. With respect to Group "A," representing from 60 to 65 per cent of all the loss on residence policies, 80 per cent coinsurance was at one time compulsory if the amount of insurance was less than \$20,000, but subsequently was made optional owing to the competitive methods of a few companies that would not agree to the compulsory plan. If coinsurance is used, manual rates are reduced by 20 per cent, whereas if not used, such

rates are increased by 10 per cent. The amount of insurance on Class "B" must be at least \$500.

Statistics of losses are now reported by the companies to a central statistical bureau, and are there compiled with reference to all the factors that enter into rate-making. Rates, although based chiefly upon experience, will vary according to territory (the country being divided into four territorial groups), classification of the risk, depending on the number of different occupants or the nature of the occupancy (there being three groups), degree of coverage, and the form of the policy.

Mercantile open stock policies, representing about 20 per cent of the total losses, insure against (1) "loss by burglary of merchandise usual to the insured's business, as described in schedule hereof, and furniture and fixtures from within the premises as hereafter defined, occasioned by any person or persons who shall have made felonious entry into the premises by actual force or violence when the premises are not open for business, of which force and violence there shall be visible marks made upon the premises at the place of such entry by tools, explosives, electricity or chemicals"; and (2) "all damage (except by fire) to such merchandise, furniture, fixtures and premises, caused by such burglarly or attempt thereat." Limitations upon the company's liability are in the main similar to those noted in connection with residence policies, except that the company does not assume responsibility (1) for loss or damage if the insured, any associate or employee is implicated in the burglary as principal or accessory; (2) for loss or damage if the premises are occupied for any purpose other than those stated in the schedule; (3) unless books and accounts are kept in such manner that the exact amount of loss can be determined accurately by the company; and (4) for loss or damage to plate glass, or lettering, or ornamentation thereon.

These policies are written subject to 80 per cent coinsurance. A maximum amount of insurance is determined for each merchant in the various classifications. The insured is then required to carry the maximum stipulated by the company. If he complies, no coinsurance is applied; if not, "the company shall not be liable for a greater proportion of any loss of or damage to the merchandise hereby insured, than the sum hereby insured bears to 80 per cent of the actual cash value of all such merchandise contained in the premises at the time such loss or damage occurs." Rates are graded on the basis of territory (two groups), and the nature of the business (three groups). They are increased for various kinds of additional coverage allowed by endorsement, or are reduced by discounts for the maintenance of an approved burglar alarm system or a watchman service.

Plate Glass Insurance.—For 1919 plate glass premiums in the United States amounted to \$17,573,386. The policy, which is standard among all companies, protects "against loss by breakage of the glass described in the schedule set forth in the policy." Such breakage, however, must be the result of accident and due to cause beyond the control of the insured, and liability is limited to the value of the glass at the time of breakage, including lettering or ornamentation thereon if the same is injured by breakage. The company has the option of paying the actual value or of replacing the glass. No liability exists for loss or damage resulting from (1) fire, whether on the insured premises or elsewhere; (2) earthquake, inundation, insurrection, riot, or military and usurped power; (3) blowing up of buildings when authorized by civil authorities; (4) scratching, chipping or defacing of the glass; (5) persons engaged in repairing or constructing the building; and (6) removal, glazing or storage of the glass. The determination of rates has been described as follows:¹

¹ See C. Tubman: "The Story of Plate Glass," p. 10.

“The method of rating has been determined by reference to a manual in which each size has been calculated in inches according to a series of tables known as table-figures to distinguish them from what are designated as book-figures, which are the amplifications of the table-figures after classifying certain kinds of Glass such as Ornamented, Clamped, Bent Glass or Location-Glass such as Arcade, Upper-floor or Mezzanine Glass. These final figures are also designated as manual premiums.

It is upon the completed manual figures that the various state rates are computed.

The basic rate or what are called the table-figures are determined by computing a certain percentage on the Official Price List of the Plate Glass manufacturers. In this price list the manufacturers have designated hundreds of measurements covering the “even-inch” dimensions of practically every plate that is turned out from the factories as a commercial product. As the price of insurance must necessarily hinge on the price of the commodity it covers, it is logical that the Plate Glass insurance rate should be figured in accordance with the price list of Glass.

All other rates are merely multipliers of the basic rate according to conditions of manufacture, exposure and location.”

Steam Boiler Insurance.—Companies writing this form of insurance collected premiums of \$5,443,000 during 1919. Two main types of policies are issued. One affords insurance “against loss sustained by the insured (1) because of damage to his property, and (2) damage to the property of others for which he is liable.” The other grants, in addition to the above protection, insurance against “loss sustained by the insured because of his liability on account of (1) the death or injury of any person employed by him, and (2) the death or injury of a person not employed by him.” The insurance may also be extended to cover use and occupancy. The loss ratio is usually very small in

this form of insurance, owing to the thorough inspection of the insured boilers and the rejection of any risk that is found defective, until the defect is remedied. The premium, therefore, is intended very largely to be compensation for service rendered rather than to meet losses. Rates depend mainly upon the number of boilers insured, the amount of insurance per boiler for any one loss, the location of the boiler in the plant, as well as its territorial location. The latter factor is proving important since the cost of transacting business and of making inspections varies with different sections of the country and with the density of power installation.

Policies stipulate a limit per accident, that is, a stated amount of insurance available for any one accident. This limit, however, is available for each accident occurring during the term of the policy. Where liability for bodily injuries is covered, it is limited to \$5,000 as regards injuries sustained by any one person, unless there is a special agreement to the contrary. Moreover, with respect to liability for bodily injuries, the insurance must be regarded as excess insurance. To quote the policy:

If there shall be, at the time of such occurrence, any other insurance in force indemnifying the insured against such liability, then the insurance provided under this policy against such liability shall be excess insurance, and not concurrent insurance, and shall be effective and applicable only after such other insurance has been exhausted in the payment of claims in respect of such liability; but if there is no such other insurance in force at such time, then the insurance provided under this policy shall be made effective and applicable.

Flywheel and Engine Breakage Insurance.—Three main types of policies are issued, namely, “flywheel,” “electrical machinery,” and “engine damage” policies.

The first relates to the explosion of any flywheel described in the schedule attached to the policy, and the last two to the breakdown of engines or electrical machines. The general nature of the coverage is similar to that discussed under steam boiler insurance, and may also be extended to include use and occupancy. During 1919, the premiums derived from this type of coverage amounted to \$1,698,816.

Windstorm and Tornado Insurance.—For 1920, 167 companies reported a premium income from this form of insurance of \$24,025,356. Practically all the companies appear to use a “standard windstorm policy,” which is similar in many respects to the standard fire policy. The coverage extends to “all direct loss and damage to the insured premises by windstorm, cyclone and tornado.” No liability exists for loss caused by (1) snowstorm, blizzard, frost or cold weather, (2) fire, explosion, tidal wave, lightning, high water, overflow or cloudburst; (3) theft; (4) neglect of the insured to preserve the property during and after a storm; and (5) water or rain, whether driven by wind or not, unless the insured premises shall first sustain an actual damage to roof or walls by the direct force of the wind. Unless otherwise provided by agreement attached to the policy, the company is also not liable for loss or damage (1) by hail, whether driven by wind or not; (2) to metal smoke stacks, awnings, signs, or temporary additions; and (3) to buildings (or their contents) in process of construction or repair unless the same are entirely enclosed and under roof.

Numerous forms, sub-dividing the insured value into its several items, are used, such as “dwelling form,” “builders’ risk form,” “farm form,” and “form for mercantile property.” Rates depend chiefly upon the kind of property insured, the territory under consideration, coinsurance, and special endorsements used. With respect to the type of property, an examination of a classified list of 87 kinds

shows that minimum rates, with 50 per cent coinsurance, vary from 6 cents to \$3.00 per \$100 of insurance. Companies also publish territorial schedules of rates, such as minimum rates for "New England and Middle States," "Inland section," and "Seacoast." All insurance is based on 50 per cent coinsurance, but should a higher percentage be accepted rates are increasingly reduced by from 10 per cent in the case of a 60 per cent clause to 35 per cent when a 100 per cent clause is used. By endorsement the insurance may also be extended to cover use and occupancy. Another leading endorsement provides that liability shall not attach until the loss caused by any one windstorm exceeds \$25.

Hail Insurance.—Sixty companies, writing this form of insurance during 1920, reported an aggregate premium income for that year of \$17,766,660. Various special policies are written, such as "nursery," "tobacco," "grain," "fruit," and "vegetable" policies. The application for insurance is usually quite detailed and sets forth the exact conditions of the agreement. Subject to these conditions, the policy insures "against all direct loss or damage by hail to the property described and for the term stated." Then follows a large space in the policy form for the insertion of special stipulations, agreements and warranties. The insurance granted is usually limited to a stated amount per acre, such as \$20 per acre for grain or \$150 for tobacco. Maximum limits per acre are ordinarily applied in the assumption of risks, such as \$150 for fruit, \$30 for grain, \$150 for tobacco, and \$100 to \$300 for vegetables, depending upon the kind. Usually liability is not assumed until the crop in question is in a developed, transplanted or healthy growing state. Rates depend upon the kind of crop and the territory (usually by states or communities) under consideration. Thus for its "eastern farm department," one leading company quotes the following rates

for the 1922 season: \$6 per \$100 for grapes, \$5 for other fruits, \$3 for grain, \$7.50 for tobacco, and \$6 for vegetables.

Rain Insurance.—This form of insurance has assumed large proportions in recent years, but unfortunately no data concerning the volume of premiums seems to be available. The introductory portion of the policy defines the coverage as extending to “loss occasioned by rain, except as herein provided.” Then follows a large blank space for the recording of the particular conditions that shall define and govern the risk. No excluded risks are mentioned in the printed text of the policy, it being simply stated that “the company shall not be liable for loss from any cause except the hazards insured against.” Provision is also made that the policy is noncancellable, unless otherwise agreed to in writing attached to the contract.

Insurance against loss by rainfall is intended for promoters of outdoor exhibitions, such as agricultural fairs, baseball games, football games, races, etc., and indoor events, such as moving picture or theatrical entertainments, concerts, expositions, etc., dependent on fair weather for success. As explained by one leading company:²

“Generally speaking, most policies cover against one-tenth or two-tenths of an inch or more of rainfall unless issued under what is known as abandonment form of policy, which is designed for events subject to abandonment or postponement on account of rainfall. Ordinarily, six to eight-hour periods of cover furnish adequate protection to the assured. In certain cases, however, as for example an event for which the receipts are continuous throughout an entire day, longer coverage is desirable. On the other hand, instances occur where sufficient protection may be accomplished in an effective period of four hours.

The policy should expire before closing hour of event or when the income would cease, or, in other words, the

² Hartford Fire Insurance Company.

period of time covered should be those hours when rainfall would most seriously affect the receipts.

Rates vary according to location and dates of event, period of time insured against loss by rainfall, amount of rainfall insured against, form of policy and probable rainfall based upon past experience in the locality where the event is to be held

No other hazards will be assumed, in connection with rain, except snow, sleet or hail, which when measured as rainfall, may be included without additional rate
.....

Where form of policy provides that insurance is based upon a stipulated amount of rainfall, definite arrangements shall be made with weather observer for ascertaining measure of rainfall during period of time covered, in which the measure of rainfall shall be determined."

A great variety of forms are used, and these must be applied to the different types of events insured. One company lists 41 kinds of events and indicates the forms of coverage applicable to each. As indicative of these forms there may be mentioned the following: "expenses—one day events"; "income from sources named—full period of event"; "income from sources named—special days"; "state and county fairs—period insurance"; "baseball abandonment—expenses—day insurance with measure of rainfall"; "without measure of rainfall"; etc.

Sprinkler Leakage Insurance.—This type of insurance is assuming prominence, owing to the wide-spread and rapidly increasing use of automatic sprinkler systems. During 1920, 114 fire insurance companies, as well as many casualty companies, reported an aggregate premium income of \$2,460,541 from this form of insurance. The form of policy used is similar for all the companies and closely resembles the standard fire policy. The coverage extends to all direct loss and damage (actual cash value) resulting from "leakage, discharge or precipitation of water from

the automatic sprinkler system," including tanks, pumps and all other parts of the system, whether originating in the insured's premises or not, and whether caused by freezing, breaking, leaky pipes, mechanical injury or defective condition. The coverage, however, does not extend to fire, lightning, tornado, windstorm, explosion, earthquake, blasting or other hazards covered by other forms of insurance. Nor does the company assume liability for the insured's neglect to use all reasonable means to preserve the property at and after a sprinkler leakage.

Large reductions in rates are made for the use of coinsurance clauses, ranging from 10 per cent to 90 per cent clauses. For example, a risk having a sound value of \$100,000, on which the rate without coinsurance is \$1.00, will have the rate reduced to 40 cents per \$100 of insurance if \$10,000 insurance is required (10 per cent coinsurance clause), and to 20 cents if \$25,000 is required. With 50 per cent or 90 per cent coinsurance, no-coinsurance rates are reduced by 88.6 per cent and 93.3 per cent respectively. Special endorsements are also used whereby the insurance is made to cover use and occupancy, or to extend to the insured's legal liability for loss or damage to the property of others, or to loss or damage resulting from the collapse or precipitation of any tank supplying the sprinkler system. Reduction in rates is also allowed if the insured agrees to maintain an approved alarm and/or watchman service.

Explosion Insurance.—The form of policy used resembles the standard fire policy, except for necessary adaptations to the particular risk. Coverage extends to "all direct loss or damage by explosion (excluding explosion originating within steam boilers, pipes, flywheels, engines and machinery connected therewith and operated thereby) to the following described property while located and contained as described in the policy." The

policy excludes liability for loss or damage by fire whether resulting from explosion or not. All the options of settlement available in fire insurance also apply here. In addition it is usually agreed that no claim will be made unless the loss exceeds \$100. Among the leading endorsements used are (1) 50 per cent coinsurance clause; (2) use and occupancy clause; and (3) "glass breakage clause," whereby the company limits its liability for this kind of damage to 10 per cent of the value of the building, subject to contribution should there be other explosion insurance on the premises. During 1920, 103 companies wrote risks of this character, and collected nearly \$1,000,000 in premiums.

Riot, Strike and Civil Commotion Insurance.—This form of insurance covers against "all direct loss or damage caused by riot, riot attending a strike, insurrection, civil commotion, explosion directly caused by any of the foregoing, and explosion from causes other than above described (excluding fire resulting from such explosion) whether originating on the premises of the insured or elsewhere." The policy is very similar to the standard fire policy, except for necessary adaptation to the particular hazard involved. No liability is assumed for loss or damage resulting from (1) explosions originating within steam boilers, pipes, flywheels, engines and machinery; (2) delay, deterioration, loss of market, or any consequential loss; (3) confiscation or authorized destruction by duly constituted government or civil authorities; (4) breakage of glass in excess of 10 per cent of the value of the building, making due allowance for contribution with other similar insurance; (5) fire or any other cause covered by any other kind of insurance; (6) military or naval forces of foreign enemies; and (7) explosion originating from any materials or process incident to the business of the insured. The policy is

usually not subject to cancellation by either party until after the expiration of ninety days, and by special endorsement ("absolute noncancellation clause") may be rendered noncancellable altogether. By special endorsements the company's liability may be extended to use and occupancy, consequential loss, explosions originating from any material or process incident to the business, and pillage and looting. Rates run from 5 cents per annum per \$100 of insurance to \$1.40, depending on the class of building, the class of occupancy, and the application of coinsurance.

Earthquake Insurance.—This form of insurance protects against "all direct loss or damage by earthquake and/or volcanic eruption and by removal from premises endangered by earthquake and/or volcanic eruption." The policy excludes from the company's liability (1) all risks of fire however caused, windstorm and/or tidal wave; (2) loss to accounts, money, evidences of debt, and similar types of property; (3) loss caused directly or indirectly by order of any civil authority; and (4) loss through theft or neglect of the insured to use all reasonable efforts to preserve the property after an earthquake or while it is endangered. Demand for this form of insurance is limited and is practically confined to the Pacific coast. Although a special form of policy is used, similar to the standard fire policy, the risk is frequently assumed by special endorsement upon the fire policy. It is customary to use in connection with this form of insurance a "10 per cent exemption clause" and a "70 per cent coinsurance clause."

Live Stock Insurance.—Total premiums derived from this form of insurance amounted to approximately \$3,000,000 during 1919. A variety of specific contracts are issued depending upon the kind of animals insured, or the commercial use to which they are put. General

policies are of two main kinds, namely, "general live stock policy" and "registered stock policy." One class of policies covers only at the home location or while temporarily elsewhere in the vicinity thereof, while another insures animals wherever they may be in the United States or Canada, including loss by any hazard of transportation. Rates depend upon the kind of animal insured, the commercial use to which it is put, age of the animal, sex, and the extent of the coverage.

The ordinary general policy insures "against loss arising from the death on the premises described in the application, or while temporarily elsewhere in the vicinity thereof, of any or all of the animals hereby insured including loss arising from the necessity of the destruction of any of said animals arising directly from any casualty, but the company shall not be liable beyond the actual cash value of any animal at the time any loss occurs in the condition in which said animal then may be. The following risks are excluded: (1) cost of removal or disposal of the remains of any animal; (2) loss resulting from any disease or injury of any animal not requiring its destruction; (3) depreciation in value resulting from such disease or injury; (4) death of any animal caused by any person, with consent of the owner, but without consent of the insurance company; (5) death caused by invasion, insurrection, riot or war; and (6) death due to the insured's carelessness or neglect, or when made necessary by order of civil authorities. Policy provisions relating to other insurance, interest of the insured, cancellation and appraisal are similar to those found in the standard fire policy.

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